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Fast Fashion Retail: a focus on Uniqlo and H&M

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## Fast Fashion retail: a focus on Uniqlo and H&M

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## Chapter 1

### The so-called “Fast Fashion”

“Fast Fashion” is a new term denoting a business model that aims to offer fashion clothes at affordable prices. The fast fashion market is crowded but at the same time it is dominated by a few main competitors. For all of them there are some fundamental critical aspects they need to considerate in order to success. Wide items assortment and items rotation, efficient and responsive supply chain, and timing are probably the most critical aspects.

The apparel industry is a highly profitable one. In the last 10-15 years the fashion market has seen the rise of the so called “fast fashion” brands, among them Inditex (Zara), H&M, Uniqlo and GAP are the market’s main players.

But we should not confuse “fast fashion” with cheap fashion. In fact, fast fashion describes not a price range, but a business model.

If we entered the term fast fashion on Wikipedia, this is the list of brands that would appear: 8seconds, Zara (Inditex Spain), United Colors of Benetton (Italy), Bestseller (Denmark) , Peacocks (UK), Bershka (Inditex), C&A (Germany), Charlotte Russe (USA), Deb Shops (USA), Comme ça ism (Japan), Forever 21 (USA), GAP (USA), H&M (Sweden), Mango (Spain), Mixxo (South Korea), NewYorker (Germany), Next (UK), Primark (Ireland), Pull & Bear (Spain), Topshop (UK), Uniqlo (Japan) and other minor ones.

What all these brands have in common is that they are not haute couture brands or trend setters, but mostly fashion followers, and usually they target the middle-low price range, and the age target under-40.

As stated in “Fast fashion: business model overview and research opportunities”<sup>1</sup>, searching the last 2 years media publications in the Factiva Database for the exact phrase “fast fashion”, and doing the same research in Google, counting all the PDF files available that contain the phrase Fast Fashion, we can list and rank the brands that

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<sup>1</sup>Fast fashion: business model overview and research opportunities, Felipe Caro and Victor Martinez de Albeniz 2014, to appear in Retail Supply Chain Management: Quantitative Models and Empirical Studies, 2nd Edition, Narendra Agrawal and Stephen A. Smith (Editors), Springer, New York, NY. The search in the Factiva database was among 7,587 articles published in the last two years that mentioned “fast fashion”. The PDF search was among 466 PDF files available to download in Google.com that mentioned fast fashion.

appear more frequently. Below a table containing these brands:

Specialty apparel retailer	number of appearances in Factiva search		number of appearances in PDF online search	
	rank	% appearances	% appearances	rank
H&M	1	31.7%	41.0%	2
Zara/Inditex	2	29.2%	45.9%	1
Gap	3	11.9%	18.2%	3
Uniqlo/Fast Retailing	4	9.9%	9.4%	8
Topshop	5	9.3%	13.7%	4
Forever 21	6	7.5%	11.2%	6
Mango	7	4.3%	12.4%	5
Wet Seal	8	3.2%	0.6%	16
Benetton	9	3.1%	10.1%	7
New Look	10	2.8%	6.2%	9
Esprit	11	2.8%	4.7%	10
C&A	12	1.9%	4.7%	11
American Apparel	13	1.2%	2.6%	13
Urban Outfitters	14	0.9%	2.8%	12
Peacocks	15	0.5%	1.1%	15
Charlotte Russe	16	0.5%	0.2%	17
Armani Exchange	17	0.3%	1.5%	14

*Table: listing and ranking of Fast Fashion brands according to the research conducted by Felipe Caro and Victor Martinez de Albeniz, source: see footnote 1*

As we can see in the table the most popular brands in this research are H&M, Zara, Gap and Uniqlo, with Zara and H&M with a number of appearances that outshine the rest. In fact both of them perfectly represent the fast fashion essence, especially Zara which is currently the market leader.

Both the companies focus their success on timing: unlike the traditional business model of fashion companies, Zara and H&M don't design their collections long before they put them on the market. They first analyse customers' preferences and then they design their collections for each season. Zara's business model's key is "to push the production moment as closer as possible to the sale moment" as Jose Luiz Nueno, marketing professor at Iese Business School, says. What we see in a Zara store was probably designer 2 weeks before.

Another success factor of the fast fashion companies, is that they continuously introduce new items in stores. For example, H&M and Zara bring new items in stores twice

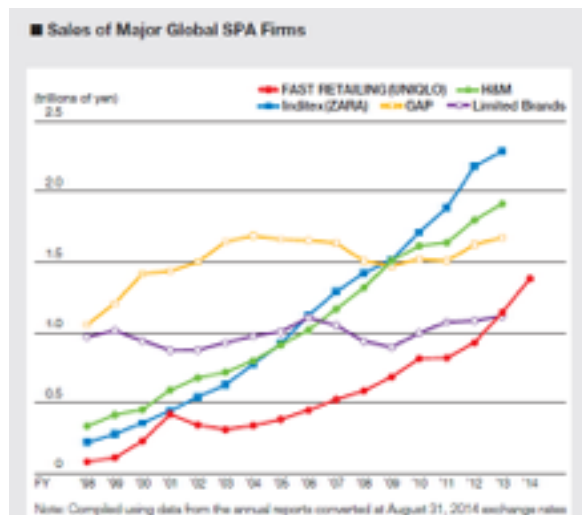


Image: sales of major global SPA firms, source: FR An-

a week, this way they are always up to date with fashion and the customers see something new every time they go to a store.

Therefore, according to the Felipe Caro and Victor Martinez de Albeniz study, we can say that the main characteristics of fast fashion business model are:

- fashionable clothes mostly for consumers under 40;
- affordable prices in the mid-to-low range;
- quick response; and
- frequent assortment changes<sup>2</sup>.

In order to be a fast fashion business model, all the requirements above should be met. For example, Old Navy has a very competitive price, but the assortment is only basic.

Especially the last 2 points, quick response and frequent assortment, are fundamental for this type of brands. The purpose of quick response is to reduce markdowns and stockout, an effective implementation of a rapid response should reduce the inventory and lead to a better gross margin.

A good way to measure the effectiveness of the quick response is the Gross Margin Return On Inventory (GMROI), which is a ratio that describes a seller's income on every unit on currency spent on inventory, relating total sales, total profit from sales and the amount of resources spent in the total sold inventory. We can get the GMROI as  $\text{Margin\%} \times (\text{Sales} / \text{Average Inventory Cost})$ .

If we compare the GMROI with the weekly new introduced products on the shop online of the 4 main players in the fashion retail market (Zara, H&M, Uniqlo and GAP), we obtain the following table:

<sup>2</sup> Fast fashion: business model overview and research opportunities, Felipe Caro and Victor Martinez de Albeniz

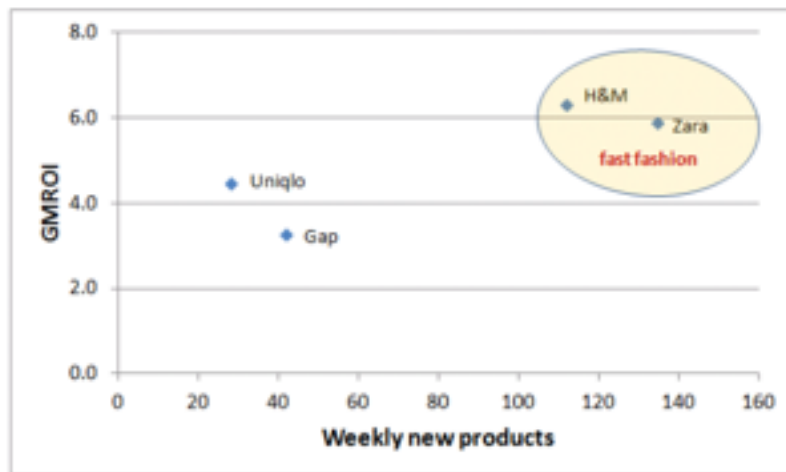


Table: GMROI vs Weekly new products, source: Felipe Caro and Victor Martinez de Albeniz study

It is evident that H&M and Zara are on a different level from Gap and Uniqlo. Not only they have a better product assortment (on average 120 new products per week), they also have a higher GMROI (50% more).

They can respond better to the new trends, so markdowns are not an issue for these 2 companies.

In conclusion, from the Felipe Caro and Victor Martinez de Albeniz study, we can say that H&M and Zara are pursuing a fast fashion business model, given the fact that both of them are meeting the 4 requirements listed above, while Uniqlo and Gap can't properly be considered as fast fashion brands. In fact the Fast Retailing's founder and CEO, Tadashi Yanai says: "We don't want to chase after 'fast-fashion' trends".

Unlike Zara and H&M, that aim to bring the latest fashion to the masses as fast as possible, Uniqlo keeps its items much longer on the shelves, making the basic items its goldmines. This helps Uniqlo to acquire the garments from the partner factories for higher volumes and lower prices. In fact Uniqlo is more long term, technology, and material innovation oriented. The CEO himself states that Uniqlo is more oriented to those customers seeking for quality more than for the last trend. The Uniqlo typical customer updates his/her wardrobe not according to the last trend, but to the last technology in material development. In an interview with Reuters<sup>3</sup>, Tadashi Yanai states that Uniqlo is not Fast fashion company, but slow fashion. It might take up to 1 year and a half from the design to the sale of an item.

<sup>3</sup> Tadashi Yanai for Reuters, "Uniqlo CEO says speed won't always win retail race", Youtube Reuters Channel, September 2012.

## Chapter 2

### Chinese fashion market

#### 2.1 Selling in China<sup>4</sup>

For all fashion brands in general, China is a very interesting market from the sales point of view. In particular, the forecasts say that in the next 10 years the number of middle and affluent class consumers, those earning at least 11 400\$ per year (2010 nominal income), will increase from 50 million in 2010 to 140 million by 2020.

The per capita consumer spending in China is still in the early part of the penetration curve compared to mature markets, therefore China has the potential to become an even more appealing market for fashion retailers, accounting for about 30% of global fashion market's growth for the next five years.

However the growth over the next 10 years will change its patterns. Moreover, given the high population of China, and its geographical extension, it is fundamental for companies to understand customers behaviour over different age segments, geographical segments from macro areas to city tiers. To that end, 6 different key-trends had been identified<sup>5</sup>:

The first three trends are related to demographic aspects: the typical Chinese heavy spender on fashion lives in big cities as Shanghai, Beijing, or a costal or provincial capital city, and is in his/her early 30s, regardless of the gender. In fact, when it comes to Chinese fashion market there is not a big difference between men's and women's spending on fashion, it is only slightly more likely to be a female.

The forecasts say that in the next 10 years however, it is likely that females will spend more than men. Up until now, men and women have spent almost equal amounts. Currently spending on men's wear represents the 46% of the total spending on fashion, while women's spending accounts 54% of the total, considering consumers aged between 14 years old and 45 living in urban areas.

However, as women's income and salary increases, the difference between women's spending on fashion and men's spending, increases consistently. When women get to earn as much as men, they tend to spend more, 1.5 to 2.5 times the amount that men

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<sup>4</sup> The whole paragraph is based on "Capturing the dynamic growth of China's fashion market" 2011, The Boston Consulting Group, bcg perspective at [www.bcgperspective.com](http://www.bcgperspective.com)

<sup>5</sup> from "Capturing the dynamic growth of China's fashion market", The Boston Consulting Group, bcg perspective at [www.bcgperspective.com](http://www.bcgperspective.com)

spend. This trend is consistent with what observed in developed markets like USA, UK and Japan.

For what concerns consumers living in low-tier cities, where the spending on fashion by men remains very close to the spending by women, or slightly higher. In fact by now the spending by men account for the 54% of the total, this difference becomes even bigger in the lowest tiers cities.

In conclusion, in the highest level cities and where women earn as much as men, women tend to spend more than men, while the proportion is the opposite as we observe low tier cities or demographic tiers where men earn more than women, men tend to spend more on fashion.

The forecast is that in the next 10 years, low tier cities will account more in the total spending on fashion. In 2010, the low tier cities made the 50% of fashion market, and it is estimated that this percentage will rise to 60% by 2020.

At the moment, companies need to be present in more than 460 Chinese cities in order to reach 80% of the market for mid-to-high priced fashion. By the 2020 they will likely need to extend there presence to 568 cities on order to maintain the same market coverage. Moreover companies will have to taylor-make their penetration strategies for the low tier cities.

The last three key-trends are related to customers' needs. previously the available offerings and channels for fashion were limited, and so where the customers' need and preferences. In fact Chinese fashion demand was focused on sportswear, with big brands and departments stores dominating. However the trend is to become more sophisticated and demanding, with the fashion offering to become more segmented by occasions and customers' emotional needs.

Moreover is it necessary to consider also how daily life is changing in China: 10 years ago in provincial cities people did not have many entertainment choices. They would go out for dinner or karaoke once a week, but for the rest of the days they would mainly go to work or school and then home. Nowadays Chinese tend to have a much wider social life, and they are mostly conscious that each occasion has its proper dress code. They go out for shopping, to dance clubs, to bars, to social events, therefore they need different outfits. For companies this means that the offering has to be wider than before and that they can shape customers' behaviour and preferences according to customers' occasion-specific needs.

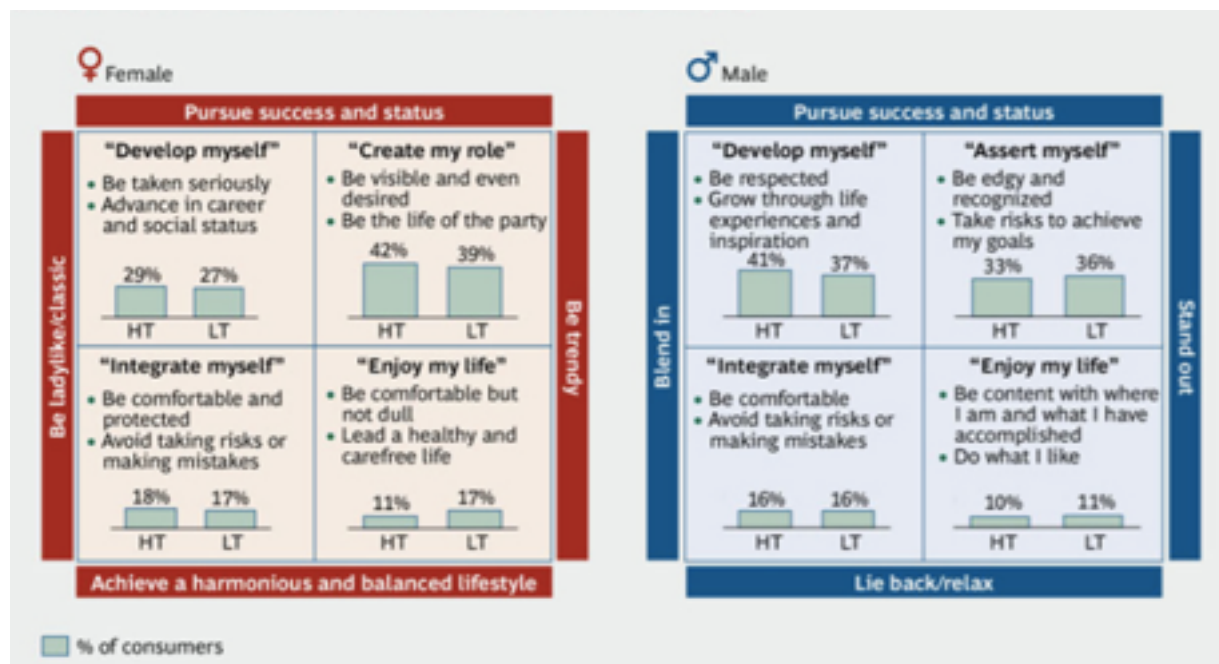
In particular, 10 years ago Chinese consumers were more brand-focused, therefore big and famous brands were succeeding since consumers were not thinking much of how a brand might reflect their personal identity or their outlook on life. Nowadays young in



their 20s-30s are more likely to state that they feel a kind of emotional fulfilment from being fashionable. In fact we can say that they find a way of expressing their desires and optimism for upward mobility and social status, being this a very common wish among young people in China, whose standard of living is improving at a speed never seen before.

This affects companies in terms that they can no longer rely only on their brand: the apparel must “strike” the customer.

At this end, the consumers’ emotional space has been segmented:



HT: high tier cities, LT: low tier cities

Table: Consumers' emotional spaces differentiated for females and males, source: BCG China fashion research survey, from [www.bcgperspective.com](http://www.bcgperspective.com)

On the vertical dimension we find the pursue of success and status vs a more lied back and relaxed lifestyle. The horizontal dimension is the fashion orientation, with the will of standing out and being trendy vs the opposite trend, blending in.

It is easy to see that in bot men and women table, Chinese consumers are success oriented, also thanks to the overall improvement of the life standards. Since in the next years women will spend more on fashion than men, high power women will become an important segment for fashion companies.

In high tier cities (HT), the will of achieving a good status, success, and professional achievement is stronger than in low tier cities. This is probably due to the fact that in

low tier capitals the cost of living is lower, therefore consumers can save more money and spend it on leisure activities and on having fun. This segment of the consumers is less focused on career and social status, therefore, at the moment, doesn't need to spend as much on fashion as a mean of communicating social status.

When it comes to the horizontal dimension, women tend to differentiate themselves and stand out, while men are more likely to blend in.

The emotional spaces evidenced in the table are:

- develop myself
- create my role
- integrate myself
- enjoy my life

Below there is the map of top brands in Chinese market according to the four emotional spaces evidenced in the previous table:



Table: map of the most popular brands in Chinese market according to the four emotional spaces, source: BCG China fashion research survey, from [www.bcgperspective.com](http://www.bcgperspective.com)

As evidenced in this Table, the two quadrants on the right (be trendy) are quite crowded, especially when the trendy is combined with achieving a harmonious and balanced lifestyle. If a company entering Chinese fashion market focused on the left side of the table, it would succeed much easier. It is crucial therefore, to formulate a targeted strategy to survive in the Chinese fashion market.

Another difficulty that companies entering Chinese market have to face, is choosing the distribution channel and the retail format. Here, again, they will have to consider the city tier and the geography.

In low tier cities, department stores and single brand store are the most popular choices. Among department stores, the premium ones should do especially well, since most of the department stores tend to be run down and state-owned affairs. Modern and sophisticated departments stores are able to create a pleasant shopping experience and often they are also weekend destinations, as well as new store openings can attract long lines.

In high tier cities department store are still contenders accounting for about 35% of apparel sales. Moreover the access to the departments store itself is highly competitive for brands, since they give them 3 months to prove they can make it. However, in this kind of cities, consumers are more demanding, expecting a more novel and positive shopping experience, therefore they started to turn away from departments store, which are of course suffering from this, and to prefer flagship stores on fancy avenues.

Basically the choice between a single brand or multi-brand retail channel depends on the brand's positioning in Chinese market. Unlike USA where department stores as Bloomingdale and Saks Fifth Avenue are doing well, in China departments stores with many different brands have started to be less appealing. Only some multi-brand retailers are I.T. in Hong Kong managed to carve out a niche focusing on emerging, trendy, and less-known specialty brands. This kind of model is good for new and small brands that have not enough resources to build a chain of flagship stores, but not for bigger and well-known brands. In fact franchisees seem to do well on Chinese market accounting for 50 to 90% of major casual and sports brands in China.

In the last few years, online shopping grew in importance among the internet generation consumers. It is estimated that the number of internet shoppers will go from 145 million in 2010 to 329 million in 2015. In fact apparel is the most popular category on online marketplaces as Taobao.

As we said above, the Chinese retail consumption will continue to grow, but there are evidences that this trend will grow slower.

#### The retail opportunity in China

	2014	2015	2016	2017	2018
Retail sales (US\$ m)	2,931,218	3,359,753	3,807,731	4,281,417	4,758,564
Retail sales growth (% real change pa)	8.8	8.7	8.6	7.9	7.8
Personal disposable income (US\$ per head)	3,394	3,830	4,274	4,729	5,172
Consumer expenditure (US\$ per head)	2,853	3,242	3,643	4,063	4,478
Percentage of households earning over US\$25,000 (%)	6.1	7.9	10.1	12.4	14.7
Number of households earning over US\$25,000 ('000)	25,811	34,152	43,727	54,486	65,656

*Image: Retail Opportunity in China, from "As one store opens....Retail in China" source: The Economist 2014*

As more households will move into higher income brackets, it is expected that there will be a migration from small businesses and street markets to the organised retail chain supported buy the expenditure of the medium level income consumers.

“Reorienting China’s investment-driven economy around private consumption is a top priority for central planners, but cuts to income growth targets suggest that progress is likely to be slow. Few provinces outside the coastal region of the country boast consumer bases big enough to drive their economies, which remain dependent on investment.”<sup>6</sup>

According to the PRC National Bureau of Statistics, 42 percent of China’s total retail sales in 2008 came from (by rank) Guangdong (Macau, Hong Kong, Gaungzhou) , Shandong (Qingdao, Jinan) , Jiangsu (Nanjing), Zhejiang (Shanghai) , and Henan (Zhengzhou), most of which are prosperous eastern provinces, on the cost or very close.<sup>7</sup>

It is expected that the costal province capitals and the main cities of China will keep on maintaining a higher level of income and therefore will keep a higher level of de-

<sup>6</sup> from: “As one store opens....Retail in China” source: The Economist 2014

<sup>7</sup> From: “Understanding China’s retail market”, Shieng Lu for China Business Review

mand of organised retailers. At the same time these areas are mature markets so setting up shops here is very expensive, mostly because ground rentals are now prohibitive.

A recent Worldwide Cost of Living Report, by the Economist Intelligence Unit found out that Shanghai now is as expensive to live in as New York City, and Beijing has the same cost of living as Washington DC and Moscow. Therefore the question now is whether to remain and reinforce the presence in these established high-margin hubs, or to join the gold rush toward the inland China, where risk and long term potential seem to be higher.

We analysed how Chinese market is from the sales point of view. However China is changing also from the industry production point of view. In the next paragraph we will discuss how the foreign investments is still hard to do, and how the production in China became more expensive than it used to be.

## 2.2 Investment and manufacturing in China

Before joining the WTO (world trade organisation) in 2001, China posed severe restriction to foreign investments in the retail sector. In order to join it, China committed to gradually eliminate market access barriers for foreign companies. Therefore the Chinese Government in 2004 issued the Administrative Measures for Foreign Investments in Commercial Sectors, which allowed foreign investors to establish retail enterprises without geographic limitations, while previously they could operate in China but only in major cities and some specific areas. This way foreign investors could operate in China through joint ventures or fully foreign owned enterprises. Furthermore from March 2010, foreign investors and individuals can establish even partnerships retail enterprises, thanks to the Administrative Measures for Foreign Enterprises or Individuals Establishing Partnership Enterprises, issued in 2009.

However there are still some sectors that are restricted to foreign investors, like audio-visual, publications, auto, pharmaceutical, pesticides, fertiliser, refined oil, grain, vegetable oil, sugar, cotton, crude oil and tobacco, this last one is totally closed to foreign investors, while the other can be accessed through a JV owned by foreign investors for a maximum of 49% and less than 30 chain stores.

Foreign investors must typically go through a stricter licensing procedure than their Chinese competitors do. First, they need to obtain the business license from MOFCOM and then the registration approval from the State Administration for Industry and Commerce (SAIC), while domestic retailers don't need to go through MOFCOM too. Moreover, the licensing procedure is "opaque" and can be very slow and inconsistent, leading to extra costs and adding blunders to the foreign investors.

Recently, pressured by foreign business communities and governments, MOFCOM and SAIC have delegated a part of the approval authority to the local governments and facilitated the procedure for foreign retail investors. However, foreign retailers that have certain retail format or work with state-controlled items, still need the central government approval<sup>8</sup>.

For the manufacturing point of you, however, the problem is connected to the rising cost of labour. It looks like China is no longer the "heaven on earth for the cheap-crap manufacturing".

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<sup>8</sup> The paragraph till this point is based on the information provided by "Understanding China's Retail Market", Sheng Lu for China Business Review, May 1st 2010.

Labour costs are rising in China, therefore more and more companies are moving out every year, relocating in South Asia countries like Vietnam (mainly), Thailand, Indonesia, Taiwan and Bangladesh. Every year more items loose their label “Made In China”, and welcome the “Made in” Vietnam.

As we can read on the report “China’s new growth model”<sup>9</sup>, by the author Yiping Huang, Professor at the Peking University and ANU, the Chinese economy is in the middle of a transition era towards a more sustainable growth model, with a lower GDP and a more balanced economic structure. During the financial crisis, the Chinese Government introduced a package of aggressive measures intended to support and boost the economic growth of the country. This lead to an increasing GDP, lifting it from 6.1 in the first quarter of 2009, to 10.7 in the last quarter of the same year. However this lead so severe problems as fiscal burdens, potential non-performing loans, overcapacity in some sectors, extreme imbalance, inflation, and asset bubble risk. Therefore in 2010, official realised there is an obvious need to start tolerating a slower growth.

A downward shift in the economic growth of Chinese economy is in line with the demographic change of the country. In the past years Chinese Government was focused on maintaining a minimum of 8% of GDP growth, seen as necessary in order to maintain the full employment and social stability. But when this 8% growth was introduced in the late ‘90s, China’s working force was increasing of 10 million people per year. In 2010, China’s working-age population decreased of 3.5 million people.

Current account surplus has decreased from 10.8 of GDP in 2007 to 2.6 in 2012, moreover the rebalancing of China’s external account is more or less done. This led many investors to believe that China’s exchange rate is close to its equilibrium. This together with other datas, shows that China’s economy is rebalancing towards a growth that is focused on consumption.

The same author states that: “In late January 2013, the Chinese National Bureau of Statistics reported a set of gini-coefficients for the years for 2003–12. They show a steady deterioration of income distribution from 0.479 in 2003 to 0.491 in 2008 and steady improvement after that, to 0.474 in 2012. These estimates are harshly criticised by many economists because they appear to contradict the general impression of continuously worsening income distribution. A more plausible view is that the observed structural changes after 2007 or 2008 tell a consistent story of rebalancing. More importantly, they are probably driven by one common cause: emerging labour shortages and rapid wage increases. (...) I have long argued that China’s reform approach can be

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<sup>9</sup> On East Asia Forum, 14th April 2013

characterised as asymmetric liberalisation, that is, complete freeing of the product markets while heavy distortions are maintained in factor markets. The generally depressed costs of production have the effect of subsidies for the corporate sector but taxes on households. This was the key mechanism contributing to both strong economic growth and growing structural imbalances during China's reform period.

This pattern has begun to change over the past several years, starting in the labour market. Rapid wage increases squeeze profit margins, slow economic growth and escalate inflationary pressure. They improve income distribution, since low-income households rely more on labour income, while high-income households depend more on corporate profits and investment returns. Rising wages also redistribute income from the corporate sector to households and, therefore, boost consumption as the share of household income in GDP increases.” Of course this has a strong impact on labour-intensive sectors. Meanwhile a rise in capita cost and energy cost has already started. This might affect mainly state-owned, highly leveraged heavy industries, since they were built on a highly distorted cost structure. However this could affect mostly state-owned industries, and be a benefit for the non-state sector, which accounts for the 80% of the industrial output.

Basically it looks like China is just turning into a normal rapidly-growing economy, with slower growth, higher inflation, more equal income distribution, more balanced economic structure, industrial upgrading and more discerned economic cycles. The Government is still facing the challenge of turning China into a high-income country in the next decades. In order to achieve it however, several reforms will be needed, for instance “liberalising the factor markets, establishing macroeconomic policy frameworks compatible with emerging market economies, and transforming the role of government from directly supporting production and investment to facilitating innovation and upgrading”<sup>10</sup>, towards an economic growth that takes into consideration also the efficiency and the quality of growth.

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<sup>10</sup> from “China's new growth model”, Yiping Huang, Professor at the Peking University and ANU.



## Chapter 3

### Uniqlo and H&M

#### 3.1 Uniqlo

Uniqlo is one of the brands owned by Fast Retailing Co. LTD, a Japanese group, born as a small men's shop called, at that time, Ogori Shoji, in May 1949. Nowadays its headquarter is in Yamaguchi, Japan, where the company was born. In 1963 Ogori Shoji Co. LTD was founded with a capital of 6 million Yen (16 000\$ in that year). In 1984 the first shop called Uniqlo opens in Hiroshima. In the summer 1985 the first roadside Uniqlo opens still in Yamaguchi, with a huge success, setting this way the new standard for the brand's stores. In 1991 the Ogori Shoji Co. Changes its name to Fast Retailing Co. And in 1994 it gets listed in the Hiroshima Stock Exchange. In 1996 it opens an office in Shibuya, Tokio to reinforce company's in-house product planning and development. In 1997 Fast Retailing gets listed in Tokyo Stock Exchange too. In 1998 the first urban store is opened in Tokyo. In 1999 an office is opened in Shanghai to enhance production management. In 2000 the online shopping starts. In 2001 the first overseas store is opened in London, as a first step to global expansion. In 2002 the Uniqlo Design Studio (now R&D center) begins operations. In 2002 the first Uniqlo store in China opens in Shanghai. In 2004 a Design Studio opens in New York, and in the same year Uniqlo creates a joint venture called FRL Korea together with Lotte Shopping, opening the first store

*Image: Principal shareholder, source: FR Investor informa-*

Principal Shareholders		
	Number of shares	Percentage of total shares in issue (%)
Tadashi Yanai	22,987,284	21.67
The Master Trust Bank of Japan, Ltd.	11,500,400	10.84
Japan Trustee Services Bank, Ltd.	8,693,900	8.20
TTY Management B.V.	5,310,000	5.01
Kazumi Yanai	4,781,808	4.51
Koji Yanai	4,780,600	4.51
Fight & Step Co., Ltd.	4,750,000	4.48
Fast Retailing Co., Ltd.	4,155,045	3.92
BNP Paribas Securities (Japan) Limited	3,642,813	3.43
Mastermind Co., Ltd.	3,610,000	3.40

1 year later. In 2005 Fast Retailing adopts a holding structure to reinforce the Uniqlo brand and develop new business opportunities. In 2006 a Uniqlo store opens in New York, the first global flagship store. In 2007 the first large-format store of 3300 square meters is opened, and in the same year the Heattech product is launched on the market generating a massive surge in sales. In 2008 Uniqlo enters Singapore, again with a joint-venture. From 2009 Uniqlo starts seeking the collaboration with fashion designers and sport celebrities, and still in that years

Uniqlo opens the first store in France. In 2009 Fast Retailing celebrates the 60th

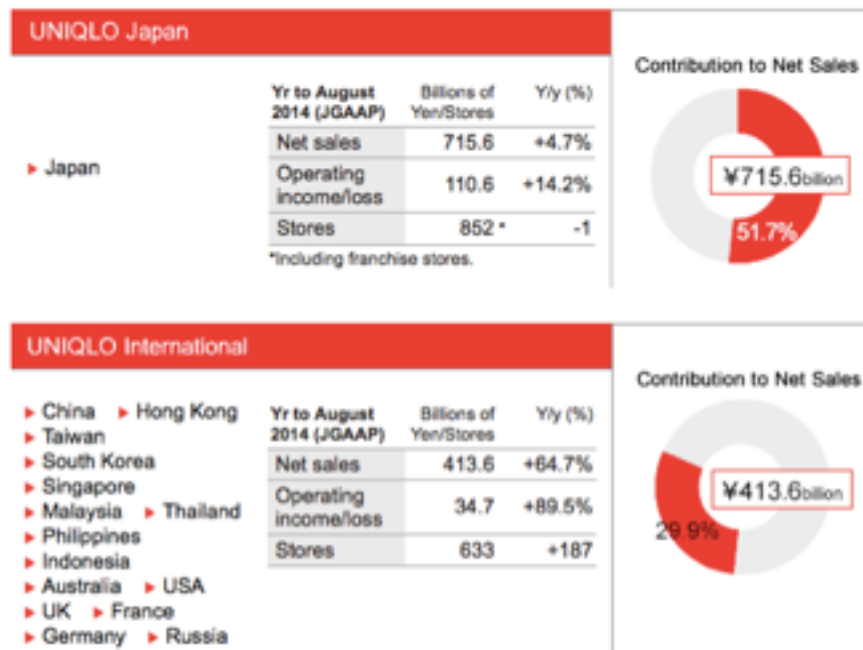


Image: Uniqlo's segments' contribution to the net sales, source: FR Annual Report 2014

anniversary with a commemorative sale, gathering 2000 people in the Ginza store at 6am. In 2010 Uniqlo opens a subsidiary in Taiwan and the first store in Russia. In 2011 Uniqlo opens a flagship store on the Fifth Avenue, and opens also the Myongdong Central Store in Seoul.

Company's overview:

Fast Retailing Co. owns Uniqlo, GU, Theory, Comptoir des Cotonniers, Princess Tam Tam and J Brand. It started opening first roadside stores and then from the '80s urban stores, opening stores in shopping area, in prominent shopping mall, and opening flagship stores.

“As an SPA (Specialty-store retailer of Private-label Apparel) controlling the entire clothes-making process from design through manufacture and retail, Uniqlo offers high-quality casual wear at reasonable prices, and products that other companies can't. Uniqlo accounts for 6.2% of the Japanese apparel market.”(FR Annual Report 2014).

Nowadays global markets are the focus of Uniqlo's growth. From the time that the first overseas store was opened in London, Uniqlo has grown to the point that it has 633 stores abroad, that concur for 37% of the totals sales, and 852 stores only in Japan. Especially China, Hong Kong, Taiwan, South Korea and other parts of Asia are generating a strong growth.

The business segments of Uniqlo are two, Uniqlo Japan, and Uniqlo International which includes all the countries where Uniqlo has stores, that means China, Hong Kong, Taiwan, South Korea, Singapore, Malaysia, Thailand, Philippines, Indonesia, Australia, USA, UK, France, Germany and Russia.

If we look at the figures we can see that Uniqlo Japan contributes for the 51.7% to the Net-sales, while Uniqlo International contributes for 29.9%.

The operating income of Uniqlo Japan has increased by 14,25 while for Uniqlo International the increase is 89,5%, mostly thanks to the new stores opened around the world. As we will see more in detail going on with this work, South Korean and China had contributed the most to this positive result.

Let's see each step in detail:

**Planning :** UNIQLO's research and design (R&D) centers analyse the latest fashions and lifestyles from around the world as well as look into new materials. Concept meetings are held roughly one year before a product's intended launch. On these occasions, designers meet with representatives from the merchandising, marketing, materials development and production departments to discuss and finalise concepts for upcoming seasons. Then UNIQLO's R&D centers prepare designs and refine samples until each product is finalised. UNIQLO can secure stable, high-volume supplies of top-quality materials at low cost by negotiating directly with materials manufacturers, and placing large-volume orders. Uniqlo considers the materials used for its core items particularly important. For example, Uniqlo sources denim to specific spinning standards and dyeing specifications from Kaihara Corporation. Uniqlo also cooperates with Toray Industries, a strategic partner, for the development of synthetic fibres, to create the HEATTECH, one of the core-products of Uniqlo. At this point the Merchandisers step in, playing a vital role from product planning through production. After meeting with the

R&D designers, merchandisers then apply the concepts for each season to product plans, materials and designs. Next, they decide the product lineup and volume for each season, paying close attention to a detailed marketing strategy. Most important merchandisers decide when to increase or reduce production during a season. Any decisions about adjusting production in line with demand are made jointly with the product planning department.

**Production:** The Uniqlo Production Offices are in Istanbul, Dhaka, Shanghai, Ho Chi Min City, and Jakarta. Production managers visit the factories every week to resolve outstanding issues. Thanks to the continuous communication with the customers, their concerns about quality are immediately communicated to the production departments and the improvements are made. The Spinning Process begins with the raw material. The cotton is blended from different localities in order to have a high and homogeneous quality level. The Takumi Team gives instructions to the partner factories on how to dye the textiles, where computer generated test colours are adjusted by specialised artisans with an eye on slightly different colours. The sewing process begins with cutting, followed by machine-sewing, in order to achieve a high precision. Finally a great dedication is put in the ironing and packing process, with regular control over the safety and quality.

**Sales:** The Inventory Control department weekly monitors sales and stocks. At the end of each season, merchandisers and the Marketing Department help coordinate the timing of markdowns and limited-period sales (typically 20-30% off the regular price) to ensure that inventory sells out. Each season, UNIQLO conducts promotional campaigns for core products. During these campaigns, UNIQLO advertises these core products' unique qualities and noteworthy features. UNIQLO Japan had 852 stores at the end of August 2014. Since the first store opened outside Japan in 2001, UNIQLO International has expanded to 633 stores, including 374 in Greater China (Mainland China, Hong Kong and Taiwan), 133 in South Korea, and 80 in Southeast Asia and Oceania. Online sales in Japan totalised ¥25.5 billion (about 213 000 000 \$) in fiscal 2014, or 3.6% of total UNIQLO sales. UNIQLO offers online sales in places including Greater China, South Korea and the United States.

Uniqlo aims to become the number 1 brand in China. Although Chinese consumers tend to prefer local brands, Uniqlo saw an important growth in the last years, reaching 100 stores in the major Chinese cities, and seeing its sales increasing of 66.8% in 2014.

Moreover the company thinks there will be a further growth given the fact that the major cities and where Uniqlo is launching already present are going through a phase of growth themselves. Uniqlo is present also in smaller Chinese cities, where they are conscious that the purchasing power is less than in big cities. Uniqlo aims to reach a number of 1000 stores in China opening roughly 100 stores per year.

As we said, Chinese consumers tend to prefer local familiar brands. But Uniqlo succeeded in launching its core products as Heattech and Ultra Light Down.

Chinese market is a very hard one for SPA companies, it is a very large territory that has to be covered where culture and customer behaviour may differ from region to region, as well as economic development, therefore each single store has to face very particular circumstances.

Uniqlo in Europe:

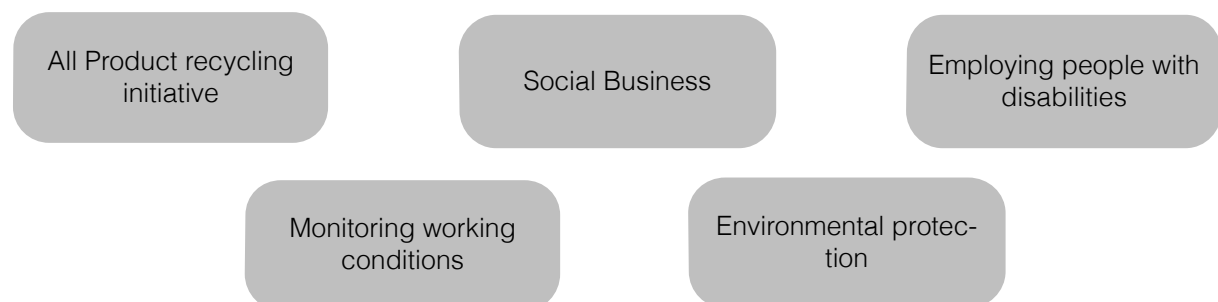
To better meet the European market Uniqlo adjusted its product offer to the local customers' needs, for example in its first European store in Germany, Uniqlo places its Heattech T-shirts in the stores earlier than in Japan, because in late summer mornings and evenings are cooler and less humid in Europe than in Japan.

Also Uniqlo is positioning its flagship stores in strategic areas: for example the La Merais store in Paris is located in an old foundry built in the mid-19th century, where the old chimney is still visible, this way visitors can also appreciate the old building.

Efficiency as a key for stable growth:

We already said that Uniqlo changes from a chain of stores locally managed to a network of flagship stores with individual authority managed by empowered employees. This way each store is "closer" to its local customers. Uniqlo believes that this way sales and profit will increase in the long term.

Corporate Social Responsibility:



*Image: CSR, source: our elaboration based on CSR description in FR Annual Report 2014*

Uniqlo cooperates with the United Nations High commissioners for Refugees and various NGOs worldwide in order to help those in need. For example in 2014 Uniqlo collected 14.2 million used garments and donated them to refugees, displaced people and victims of natural disasters. In April the same year Uniqlo launched a campaign for collection warm clothes in Japan in order to donated them to Syrian refugees in Jordan. Donators were invited to write a short message of hope on a hearth shaped coloured paper, so that they, together with Uniqlo, could deliver a encouraging and warm hearted message to those in need, along with warm clothes.

For what concerns production, Uniqlo works together with partner factories and



*Image: Uniqlo recycle, source: FR Annual report 2014*

therefore has a code of conduct to guarantee safe and appropriate working conditions to the factory workers. In order to achieve this Uniqlo uses external institutions to regularly inspect the partner factories, to detect unlawful conditions, child or forced labor, unauthorised overtime work and ensure safe working conditions. If Uniqlo detects any violation of its code of conduct, and the partner factory does not improve and revise its condition, Uniqlo can reduce its production order or even cancel the partnership. In 2014 Fast Retailing monitored 332 partner factories, among those 7 are were operation in highly unethical and and health offensive conditions.

In 2014 Uniqlo institutes also a new Environmental Strategy aiming to reduce the impact on the environment of the whole supply chain process. Not only Fast Retailing expects its partner factories to care about working conditions, but also to protect the environment. Under its Environmental Guidebook, Fast retailing monitors 6 different areas: environmental management, Chemicals management, waste material management and disposal, treatment of asbestos and PCBs, measurement and management of effluents, workers' health and safety.

Financial situation:

## Consolidated Statement of Comprehensive Income

FAST RETAILING CO., LTD. and consolidated subsidiaries  
For the years ended August 31, 2013 and 2014

	Millions of yen		Thousands of U.S. dollars
	2013	2014	2014
Profit for the year	¥107,474	¥79,337	\$764,775
Other comprehensive income			
Other comprehensive income that will not be reclassified to profit or loss	—	—	—
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Net gain(loss) on revaluation of available-for-sale investments	207	66	641
Exchange differences on translation of foreign operations	19,462	8,402	80,994
Cash flow hedges	84,405	(5,773)	(55,655)
Other comprehensive income, net of taxes	¥104,075	¥ 2,695	\$ 25,980
Total comprehensive income for the year	¥211,550	¥82,033	\$790,755
Attributable to:			
Owners of the parent	205,660	75,517	727,954
Non-controlling interests	5,890	6,515	62,801
Total comprehensive income for the year	¥211,550	¥82,033	\$790,755

See accompanying notes to consolidated financial statements.

Image: Consolidated statement of comprehensive income, source: FR Annual Report 2014

Above the Consolidated Statement of Income of Fast Retailing.

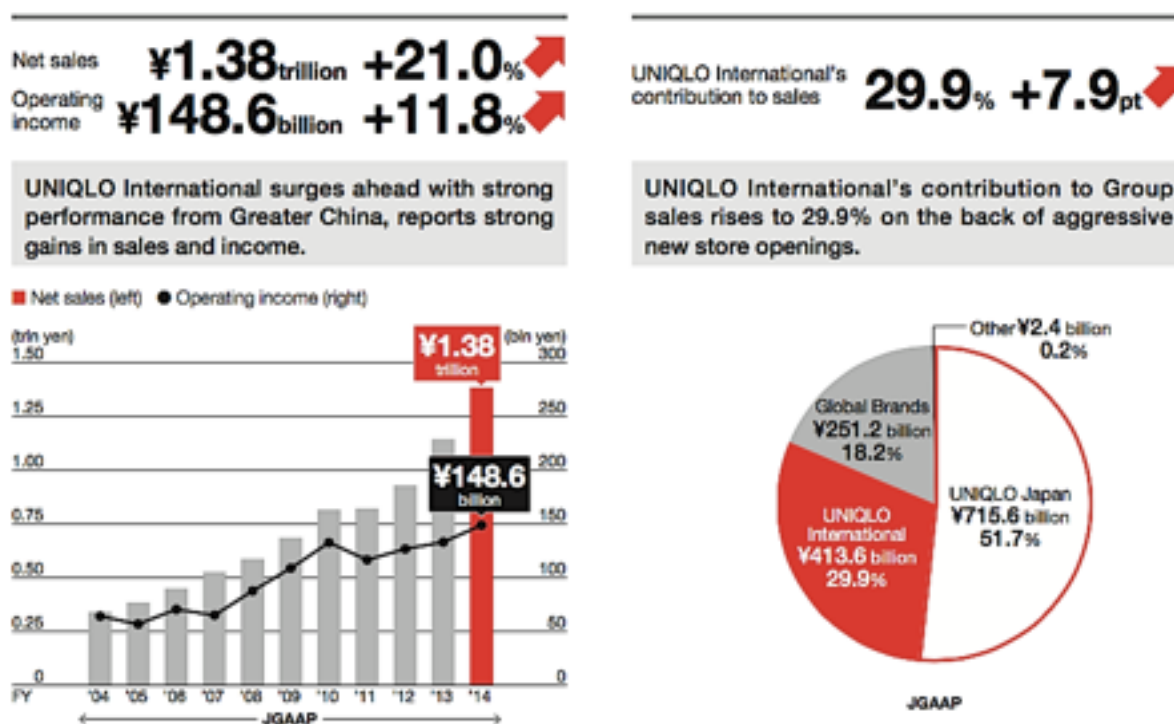


Image: Financial Highlights of the year, Source: FR Annual Report 2014



	Millions of yen (except per share data and other data)		Thousands of U.S. dollars*4	
	JGAAP			
	2013	2014	YoY	2014
<b>■ For the year</b>				
Net sales/Revenue	1,143,003	¥1,382,907	+21.0%	\$13,330,513
Operating income/Operating profit	132,920	148,646	+11.8	1,432,875
EBITDA*1	161,908	185,434	+14.5	1,787,505
Income before income taxes and minority interests/ Profit before income taxes	141,525	140,115	(1.0)	1,350,645
Net income/Profit attributable to owners of the parent	90,377	78,118	(13.6)	753,019
Net cash provided by operating activities/ Net cash from operating activities	99,439	111,399	+12.0	1,073,831
Net cash used in investing activities	(63,901)	(63,574)	(0.5)	(612,824)
Free cash flow*2	35,538	47,825	+34.6	461,007
Net cash used in financing activities	(23,945)	(30,014)	+58.8	(366,437)
Cash and cash equivalents*3	295,622	313,746	+6.1	3,024,357
Depreciation and amortization	23,691	30,828	+30.1	297,170
Capital expenditures	39,681	58,343	+47.0	562,404

	Millions of yen (except per share data and other data)		Thousands of U.S. dollars*4	
	IFRS			
	2013	2014	YoY	2014
■ For the year				
Net sales/Revenue	¥1,142,971	¥1,382,935	+21.0%	\$13,330,782
Operating income/Operating profit	134,101	130,402	(2.8)	1,257,017
EBITDA*1	157,708	161,210	+2.2	1,553,993
Income before income taxes and minority interests/ Profit before income taxes	155,732	135,470	(13.0)	1,305,869
Net income/Profit attributable to owners of the parent	104,595	74,546	(28.7)	718,593
Net cash provided by operating activities/ Net cash from operating activities	99,474	110,595	+11.2	1,066,063
Net cash used in investing activities	(62,584)	(56,323)	(10.0)	(542,931)
Free cash flow*2	36,890	54,272	+47.1	523,152
Net cash used in financing activities	(24,226)	(44,060)	+81.9	(424,724)
Cash and cash equivalents*3	296,708	314,049	+5.8	3,027,275
Depreciation and amortization	23,607	30,808	+30.5	296,975
Capital expenditures	39,681	58,814	+48.2	566,945

Image: Comparison between Operating Income according to JGAAP e IFRS, source: FR Annual Report 2014

Above an adaptation of the Uniqlo Annual Report 2014 in order to make it easily comparable. It is interesting to see how the Operating Income comes different when calculated in accordance with JGAAP ( Japanese Generally Accepted Accounting Principles ) and when using IFRS (International Financial Reporting Standard)<sup>11</sup>.

<sup>11</sup> For further information about JGAAP and IFRS comparison see “ JGAAP-IFRS comparison” english version 3.0 (equivalent of Japanese version 4.0) Ernst&Young ShinNihon LLC 2011.



Under JGAAP the operating income is 148.6 billion Yen, while under IFRS is 130.4 billion. This 18.2 billion can be explained by<sup>12</sup>:

1. The J-Brand loss of 12.7 billion Yen is reported as special loss under JGAAP, but under IFRS is part of other expenses, and is therefore subtracted from the operating income.
2. a 6.6 billion Yen of amortisation of J-Brand intangible assets and goodwill under JGAAP, is an additional impairment loss under IFRS, and therefore subtracted from the operating income.
3. a 3.9 billion Yen of foreign exchange gains is a non operation income under JGAAP, but is part of other income for IFRS and added to the operating income.
4. a 5.9 billion Yen in goodwill amortisation for JGAAP, is not recorded under IFRS, increasing the operating income of an equal amount.

#### ■ Performance by Business Segment JGAAP

FY	2014			2013		
	Billions of yen	YoY change Billions of yen	% change	Billions of yen	YoY change Billions of yen	% change
UNIQLO Japan						
Net sales	¥715.6	¥32.3	+4.7	¥683.3	¥63.2	+10.2
Operating income	110.6	13.8	+14.2	96.8	-5.4	-5.4
UNIQLO International						
Net sales	413.6	162.4	+64.7	251.1	98.0	+64.0
Operating income	34.7	16.4	+89.5	18.3	7.3	+66.8
Global Brands*						
Net sales	251.2	44.9	+21.8	206.2	53.2	+34.8
Operating income	16.3	-1.1	-6.6	17.4	2.9	+20.1

\* Global Brands includes GU, Theory, Comptoir des Cotonniers, Princesse tam.tam and J Brand operations.

Note: Consolidated sales also include items reported by the holding company, Fast Retailing Co., Ltd., such as real estate leasing. Consolidated operating income includes FFI operating income and goodwill amortization.

Image: Performance by Business Segment JGAAP, Source: FR Annual Report 2014

Net sales for both Uniqlo Japan and Uniqlo International have raised. This thanks to opening of new stores overseas (+187), especially in Greater China (+83) and South Korea (+31). On the other hand the net income for J-Brand dropped 13.6%, due to the 12.7 billion Yen loss. However the overall group performance for Fast Retailing remains positive with a rise in net sales and income for the fiscal 2014, with consolidated sales of 1.38 trillion Yen (+21%) and operation income of

#### ■ Number of Stores by Business Segment

FY	2014			2013
Unit: Stores	End-Aug.	Open	Close	End-Aug.
UNIQLO Japan:	852	54	55	853
Directly operated	831	51	54	834
Large-scale	199	26	4	177
Standard	632	25	50	657
Franchise	21	3	1	19
UNIQLO International:	633	193	6	446
China	306	83	2	225
Hong Kong	22	5	1	18
Taiwan	46	9	0	37
South Korea	133	31	3	105
Singapore	18	6	0	12
Malaysia	21	11	0	10
Thailand	20	10	0	10
The Philippines	16	10	0	6
Indonesia	4	3	0	1
Australia	1	1	0	0
U.S.	25	18	0	7
U.K.	10	0	0	10
France	6	3	0	3
Russia	4	2	0	2
Germany	1	1	0	0

Image: Number of stores by business segment, source: FR Annual Report 2014

<sup>12</sup> as stated by the Uniqlo Annual Report 2014 itself.

148.6 billion Yen.

Uniqlo Japan have been performing well with an increase in net sales of 4.7%, and in net income of 14.2%, also thanks to the good performance of core products as Heat-tech, AIRism and Ultra Light Down.

Uniqlo Japan also increased the average shop floor space of 4.4% reaching 882 m2 on average.

Uniqlo International reported significantly good results increasing the results of 64.7% for net sales, and 89.5% for net income. Especially greater China, reporting a growth of 66.5% in net sales and 83% in net income, and South Korea did very well.

Uniqlo Japan has 2014 Revenues of 715.6 billion Yen, the International segment has 413,6 billion Yen. The respective Operating profits are 103,6 and 32,9 billion Yen. Which makes the Operating Margins be 14,9% and 8,0%.

### 3.2 H&M

H&M stays for Hennes & Mauritz and it comprehends a group of six brands and 3500 stores around the world.

The first store opened in 1947 in Västerås, Sweden, and five years later a second store opened in Stockholm. In 1964 the first store outside Sweden was opened in Norway. At that time the name of the stores was just Hennes. In 1968 the founder buys Mauritz Widforss, a hunting and fishing equipment store. The name is changed into Hennes & Mauritz. In 1974 H&M gets listed in the Stockholm Stock Exchange. From the '80s on, H&M goes international opening stores all over Europe and in USA, and in 1998 the online shopping begins. While still growing international, the first store in Asia opens in Hong Kong in 2007. In 2008 a store is opened in Tokyo, and H&M acquires a fashion firm called FaBric Scandinavien AB, which comprises the brands Weekday, Monki and Cheap Monday. In 2010 H&M opens its first store in South Korea and becomes the world's largest consumer of organic cotton and continues to increase its use of sustainable materials in the following years. In that same year H&M opens in Osaka the store number 2000. In 2013 the first stores in the Southern Hemisphere open in Indonesia and Chile. In the same year H&M starts the Garment Collecting and it is the first fashion company to launch collections made with recycled materials. In 2014 H&M enters Philippines and Australia and opens online-stores for Italy, France, Spain and China. Moreover H&M in 2014 won the Fairness Award from the Global Fairness Initiative in Washington, which recognises efforts to create opportunities in poor countries.

#### Company's Overview:

H&M went from a single women clothes shop in Sweden to a group of 6 brands and 3500 shops all over the world. The Hennes & Mauritz group includes the brands H&M, COS, Monki, Weekday, Cheap Monday, and & Other Stories, that was launched in 2013. Moreover H&M has also the branch H&M Home, which provides home accessories. COS is a very classical line, Monki is more playful and personal, Weekday is jeans-focused with a very urban style, Cheap Monday offered denim to men, women and young with a very up-to-the-minute fashion catwalk de-

sign, while & Other Stories is a new line denim and fine materials focused, offering clothes for both men and women, as well as shoes, accessories and cosmetics.

H&M's mission is to offer to everyone in every market fashion and quality at the best price and in a sustainable way<sup>13</sup>. H&M is targeting women, men, teenagers and children in 55 countries. It aims to offer design, quality, sustainability and fashion with unbeatable price. In particular it ensures the best price by:

- in-house design
- no middlemen: in many markets H&M is a direct buyer and seller
- large purchasing volumes
- buying the right product from the right market
- efficient logistic
- cost-consciousness in all parts of the organisation<sup>14</sup>

H&M doesn't have its own factories but buys from long term strategic suppliers.

H&M point to form international work teams with employees from all over the world. In 2014 the group counted 132 000 employees, 3511 stores in 55 countries and sales for 176.6 billion SEK (more or less 21.02 billion USD), and it is aiming to increase the overall stores number of 10-15% per year, for instance in 2014 H&M opened 379 new stores and opened online shopping in France, Italy, Spain and China.

H&M sees Asia as the focus of its present and future expansion. its latest markets are Philippines, South Korea, China, Japan, Singapore, Malaysia, Thailand and Indonesia. in 2014 only in China it opened 86 new stores, counting a total of 291 stores in China. as many SPA companies, H&M tends to open flagship stores in the hottest spots of the biggest and medium size cities all over the world. China and USA are the most relevant markets for H&M at the moment. While entering new markets, the company also straighten its position in the "old" markets, for instance opening the online shopping in more countries every year. h&m.com online store is one of the most visited fashion websites in the world. Another strategy H&M is pursuing is the cooperation with famous designers: since 2004 when H&M collab-

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<sup>13</sup> H&M Business Concept [www.about.hm.com](http://www.about.hm.com)

<sup>14</sup> from H&M business concept at [www.about.hm.com](http://www.about.hm.com)

orated for the first time with Karl Lagerfeld creating a very sharp-cut collection of evening and party dressed, the company kept on working with designers like Lanvin, Versace, Viktor&Rolf and so on.

H&M is a pioneer in the pursuit of vertical integration: the design is made by more than 100 designers in Sweden, while the production is outsourced to 800 suppliers, about 60% of the production takes place in Asia (mostly in Bangladesh), and the rest in Europe. H&M offers during the year 2 main collections: spring and fall. Then it integrated these two with several sub-collections. The main two are mostly classical, long-lead pieces, while the sub-collections are more fashion trendy items.

This way H&M uses its resource as designers, factories and distribution in a balanced way, instead of having two peaks a year, and it refreshes continuously the range of products available in stores.

In order to react quickly to the market, H&M located its production offices close to the production facilities. These offices are in charge of reviewing samples, quality and choosing the suppliers. The long lead items are produced mainly in Asia, while the trendy items in Europe. Moreover, the company has a highly efficient IT infrastructure: each store is connected with corporate logistics, procurement system and the central warehouse. All the executives can access the system, this way they are into the whole process, from the design to sale. This is how H&M has an affective management during the whole process<sup>15</sup>.



*Image: The Fashion Triangle, source: Fast Fashion, Business Model Overview and research Opportunities, Felipe Caro and Victor Martinez-de-Albeniz, January 24 2014*

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<sup>15</sup> from "The future of Fashion Retailing", Greg Pedro for Forbes 10/23/2012

In fact, H&M has an almost “on demand” offer, focusing on single items instead of focusing on collection, this is possible because the company controls the whole process till the distribution and sale.

H&M, as well as many fast fashion companies, classifies its products into 3 categories: Fashion, which are mostly short-lead trendy products that need to be available in store in a very short time in order to respond quickly to nascent trends in fashion. Fashion-basic product, are in the middle between classics and trendy items. They might have some trendy inspiration but they are produced as basics, with varying volume. Lastly Basic items, where the separation between Basic and Fashion-Basic is very blurry, they actually might be the same category. Basic items are about 70% of H&M product assortment<sup>16</sup>.

H&M has sales Revenues for 151 419 million SEK, excluding VAT, and an Operating Profit of 89 052 million SEK, which makes a Gross Margin of 58,8%.

Financial situation:

SEKM 1 DECEMBER - 30 NOVEMBER	2014	2013**
Sales including VAT	176,620	150,090
Sales excluding VAT, note 3, 4	151,419	128,562
Cost of goods sold, note 6, 8	-62,367	-52,537
<b>GROSS PROFIT</b>	<b>89,052</b>	<b>76,025</b>
Selling expenses, note 6, 8	-58,525	-49,944
Administrative expenses, note 6, 8, 9	-4,944	-3,891
<b>OPERATING PROFIT</b>	<b>25,583</b>	<b>22,090</b>
Interest income	328	367
Interest expense	-16	-9
<b>PROFIT AFTER FINANCIAL ITEMS</b>	<b>25,895</b>	<b>22,448</b>
Tax, note 10	-5,919	-5,355
<b>PROFIT FOR THE YEAR</b>	<b>19,976</b>	<b>17,093</b>
All profit for the year is attributable to the shareholders of the parent company H & M Hennes & Mauritz AB.		
Earnings per share, SEK*	12.07	10.33
Number of shares, thousands*	1,655,072	1,655,072
* Before and after dilution.		

*Image: H&M group income statement, Source: H&M 2014 Annual Report*

<sup>16</sup> figures according H&M 2010

### 3.3 Both Uniqlo and H&M are focusing on China

As we already said the Chinese fashion market is a very appealing one, even if its growth is growing slower compared to a few years ago.

Uniqlo opened its first Chinese store in Shanghai in 2002, while H&M opened a few years later, in 2007, still in Shanghai. Both the companies, as most of the apparel retailers that enter Chinese market, started opening flagship stores in major Chinese cities, gradually trying to enter the second tiers cities. Uniqlo is counting 363 stores in China (31 May 2015), while H&M has 291 (30 November 2014). The online stores open in 2009 for Uniqlo and in 2014 for H&M. Both the companies are facing a very aggressive store opening strategy. H&M plans to keep on increasing the store number of 10-15% per year, while Uniqlo declared they intend to keep on opening an average of 100 stores per year in China. However Chinese apparel market is extremely competitive, and all the four main global players ( Inditex, H&M Fast Retailing and Gap) are fiercely fighting for the market share, seeing Inditex as the most successful foreign player in Chinese market.

In the last years Chinese fashion market has changed enormously. Once upon a time European brands could open a store in China being sure that they will sell: “If it was manufactured in Europe, had a swanky heritage or slick advertising, it was enough to reap profits in an ever-buoyant Chinese market”<sup>17</sup>. Times have changed. As we already said, Chinese consumers are more demanding. They don’t buy anymore whatever is put in front of them or whatever has a “big” brand. They are demanding quality, trendy garments for reasonable prices, and new shopping experiences. Wages are rising and Chinese consumers have now a stronger purchase power.

For years there had been a gap between high end luxury brands and sportswear: H&M had been sly enough to enter Chinese market and filling that gap. In fact young Chinese seem to appreciate H&M’s design. However since H&M introduced the online shopping, sales from stores are slightly going down in major cities, where customers tend to buy more on the internet, compared to low tier cities. The Chinese fashion market is extremely fragmented, the market leader by share, a Chinese company called Belle International Holding Ltd, holds 1% market share. However brands like Zara, H&M and Uniqlo can still rely on their brand power. For instance, H&M relies on the

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<sup>17</sup> from “China’s changing fashion landscape” fashionunited.com February 16th 2015

fact that, as one of their stores opens, the hosting shopping mall sees an increase of customer affluence by 10%<sup>18</sup>.

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<sup>18</sup> From “At H&M 3000 stores are counting”, Wall Street Journal, 26 September 2013.



## Chapter 4

### Governance and cultural background

#### 4.1. Governance Models

The corporate governance models of Japan and Sweden are very different, each one with its peculiarities.

- I. Japan: The Japanese industrial policy had always been heavily influenced by the government ministries, which always have an enormous regulatory control. However the regulation is very fragmented. Nowadays, since many Japanese companies are international, they are less connected to the domestic market, seeing, in the years, a wider opening to global standards. “Government agencies provide little effective, independent regulation of the Japanese securities industry. This is somewhat ironic, because the regulatory framework in Japan was modelled on the US system by US occupation forces after the Second World War. Despite numerous revisions, the core of Japan’s securities laws remain very similar to US laws.”<sup>19</sup> The Japanese Corporate Governance model is characterised by a highly concentrated ownership in the hands of one or very few big shareholders. Often the major shareholders are affiliated banks and companies. Traditionally, in fact, corporations were always tightly linked with banks, with which they had a strong long term relationship. Here is the difference with the US regulation: the bank provides its corporate client with loans as well as services related to bond issues, equity issues, settlement accounts, and related consulting services. In the USA, such a strong control and multiple services irrigated by one single bank would not be acceptable. Another key characteristic of the Japanese corporate governance, is the focus on the network, called keiretsu. The Keiretsu is an industrial groups linked by trading relationships as well as cross-shareholdings of debt and equity. The Board of Directors in Japan, is often composed almost entirely by insiders, that is executive managers, heads of executive divisions. This organ is the central administrative body. “If a company’s profits fall over an extended period, the main bank and members of the keiretsu may remove directors and appoint their own candidates to the company’s board. Another practice common in Japan is the appointment of retiring govern-

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<sup>19</sup> From: [emergingmarketsesg.net](http://emergingmarketsesg.net)

ment bureaucrats to corporate boards; for example, the Ministry of Finance may

(As of February 28, 2015)

Name	Number of Shares	Percentage of Total Shares in Issue
Tadashi Yanai	22,987,284	21.67
The Master Trust Bank of Japan, Ltd. (Trust account)	11,706,600	11.04
Japan Trustee Services Bank, Ltd. (Trust account)	9,032,100	8.51
TTY Management B.V.	5,310,000	5.01
Kazumi Yanai	4,781,808	4.51
Koji Yanai	4,780,600	4.51
Fight & Step Co., Ltd.	4,750,000	4.48
FAST RETAILING CO., LTD.	4,139,473	3.90
BNP Paribas Securites (Japan) Limited	3,683,389	3.47
MASTERMIND Co., Ltd.	3,610,000	3.40

appoint a retiring official to a bank's board.”<sup>20</sup>

*Image: Fast Retailing Shareholders' composition, Source:fastretailing.com*

Tadashi Yanai is the son of the founder of Ogori Shoji. He joined the father's company in 1972. He opened the first store called Uniqlo in Hiroshima, and changed the name from Ogori Shoji to Fast Retailing in 1991. He is the President, Chairman and CEO of Fast Retailing and major shareholder. TTY Management B.V. is fully owned by Mr. Yanai. Kazumi and Koji Yanai are Tadashi Yanai's sons.

Tadashi Yanai is the richest man in Japan and is ranked as 35th richest person in the world with a 24.4 billion \$ asset.

- II. Sweden<sup>21</sup>: the Swedish companies refer to The Swedish Companies Act, The Swedish Corporate Governance Code, and the listing requirements and agreements applicable on the stock exchange. Moreover the Swedish Security Council, stated what is regarded as accepted practice on the Swedish stock exchange market. In the Act, there is stated that Swedish companies must have three decision-making organs, which are, in hierarchical order: the Shareholders' Meeting, the Board of Di-

<sup>20</sup>From: [emergingmarketsesg.net](http://emergingmarketsesg.net)

<sup>21</sup> Based on what provided by [corporategovernanceboard.se](http://corporategovernanceboard.se)

rectors, and the CEO. In addition, there must be a controller, which is the Auditor,



*Image: Swedish Corporate Governance Organs, Source: [corporategovernanceboard.se](http://corporategovernanceboard.se)*

appointed by the Shareholders' Meeting.

Unlike USA and UK, the Swedish ownership is usually quite concentrated in the hands of one or a few major shareholders, like other European continental models. The major shareholders often play an active role taking decisions and responsibility by sitting in the Board of Directors, for example. However the Act contains a number of provisions to protect the smaller shareholders from the power of the major ones, for example prescribing the qualified majority for some specific decisions. The Shareholders' meeting is the highest decision-making organ in Swedish companies, that has a sovereign over the Board of Directors and the CEO. Each shareholder has the right to participate and vote in the Shareholders' Meeting, regardless of the shares he has, as well as the right of posing questions and issues within the Meeting. "The annual general meeting must be held within six months of the end of the financial year, in order to decide on whether to adopt the income statement and balance sheet, and decide on the appropriation of profits or losses. The meeting also decides on discharge of liability for members of the board and the chief executive officer, as well as other issues on which it is obliged by law or its articles of association to decide, such as the election of members of the board and the auditor. Board and auditor fees are also decided by the shareholders' meeting."<sup>22</sup> The Swedish

<sup>22</sup> From [corporategovernanceboard.se](http://corporategovernanceboard.se)

Shareholders' Meeting has decision making power over different issues, unless attributed to a different organ, by law.

The Board of Directors is responsible for the company's organisation and management of company's business. The Board has an extensive decision making power, given only the limits concerning some matter which are delegated to the Shareholders' Meeting, as for instance, nomination of Auditor, changes to the articles of association, and adoption of balance sheet and income statement. The Board must consist in at least 3 members, among whom 1 is the appointed Chairman, who has lead of the Board and has to fulfil some legal obligations. "Current OMX Nordic Exchange Stockholm regulations stipulate that no more than one of the directors, elected by the shareholders' meeting, may be on the executive management team of the company or one of its subsidiaries. Normally, this place is taken by the CEO. However, many companies have no member of the executive management on the board."<sup>23</sup> If the company is listed, most of the Directors are non executives. The stock exchange regulation also recommend that they should be independent from the company and its management. At least 2 must be independent from companies major shareholders, which means that the Board can actually have a majority of Directors that have a bond with the main shareholders, however this is in line with the favourable view that the Act has of the ownership participating actively in the company's life.

The CEO is responsible for the company's day-to-day management, unless so, he has to present the issues to the rest of the Board, which must have provided previously the rules that classifies issues as not belonging to the day-to-day management. The CEO is a subordinate to the Board, which instructed him on how to handle and cope with everyday issues. The CEO and the chairman are 2 different individuals, and the first one may be belonging to the Board, but not be the chair.

The last organ we mentioned is the Auditor, which is normally appointed by the Shareholders' Meeting. The Auditor is in charge of examination the company's accounts and accounting practices, as well as reviewing the Board's and CEO's management of the company.

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<sup>23</sup>From [corporategovernanceboard.se](http://corporategovernanceboard.se)

Therefore the main characteristics of the Swedish Corporate Governance are<sup>24</sup>:

- concentration of ownership structure
- deep rooted alliance between financial entrepreneurs and wealthy families on one hand, and engineers and technology innovators on the other hand
- a tight control by the shareholders over the management of the company
- powerful CEOs, who are loyal to the major Shareholders, since they have the power of bypassing the CEO to get information about his/her management, and eventually to dismiss him.
- control and information transparency

The Chairman Steffan Persson is the son of the founder of Hennes and Mauritz. He and the Persson family are the main shareholders of H&M, with a 69.71% of voting shares. Stefan Persson is also the richest man in Sweden, and, according to Forbes, is the 12th richest man in the world. The second largest shareholder of the company is Lottie Tham and family, with 2.59% of voting shares, while the rest of the shareholders have shares for less than 1%. Lottie Tham, sister of Steffan Persson. She is mainly involved in real estate and hotel business.

Karl-Johan Persson, aged 40, is the CEO of H&M. He joined the company in 2005, after selling his event management business, which he purchased in 2001 and brought to be the most successful event management business in Scandinavia.

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<sup>24</sup> List based on Corporate Governance in Sweden, An International Trade Union Perspective, author: Pierre Habbard – TUAC Secretariat for the Hans Böckler Foundation in partnership with the Global Union Research Network Paris, February 2008

## 4.2. Cultural background analysis

In order to provide a full analysis of the two companies, it is useful to give a look at the cultural background of the two respective countries: Japan and Sweden. They are 9 000 Km away from in each other, belonging to different continents. It is therefore legitimate to expect a big cultural difference, such to impact on the management of the two companies.

In order to proceed in this analysis, we will refer to the studies conducted by Professor Geert Hofstede, and Professors Fons Trompenaars.

Geert Hofstede conducted one of the most comprehensive studies about cultural influence over values in the workplace. At this end, he defines culture as “the collective programming of the mind distinguishing the members of one group or category of people from others”. Therefor he outlined 6 distinctive dimensions of national culture:

- I. Power Distance Index (PDI): this dimension expresses the degree to which the less powerful members of society accept and expect that power is distributed unequally. The central point here is how a society handles inequalities among people. Societies where the the degree of power Distance is high, are more likely to outline a hierarchy where the individuals have their place and there is no need to further justification. On the opposite, in societies with low degree of power distance, people strive to equalise the distribution of power and demand justification where this is unequally distributed.
- II. Individualism versus Collectivism: In individualistic societies the relationship between humans are a bit more loosely-knit, and society expects individuals to take care of themselves and only their immediate relatives, we can say that the focus is on the individuals. On the opposite, collectivistic countries are characterised by tight social relationships, and a strong attention is given to the loyalty of each individual to its social group. Here individuals are expected to help relatives and those who belong to the same social group. In this dimension, the score depends on if the individual thinks of himself as “I” or “we”.
- III. Masculinity vs Femininity (MAS): the masculinity-side of this dimension represent the preference for achievement, heroism, assertiveness and material reward for success. A “masculine” society is competitive and success-oriented. Its opposite, femininity, stands for a preference towards cooperation, modesty, caring for the weak and quality of life. This second type of society is more is more consensus-

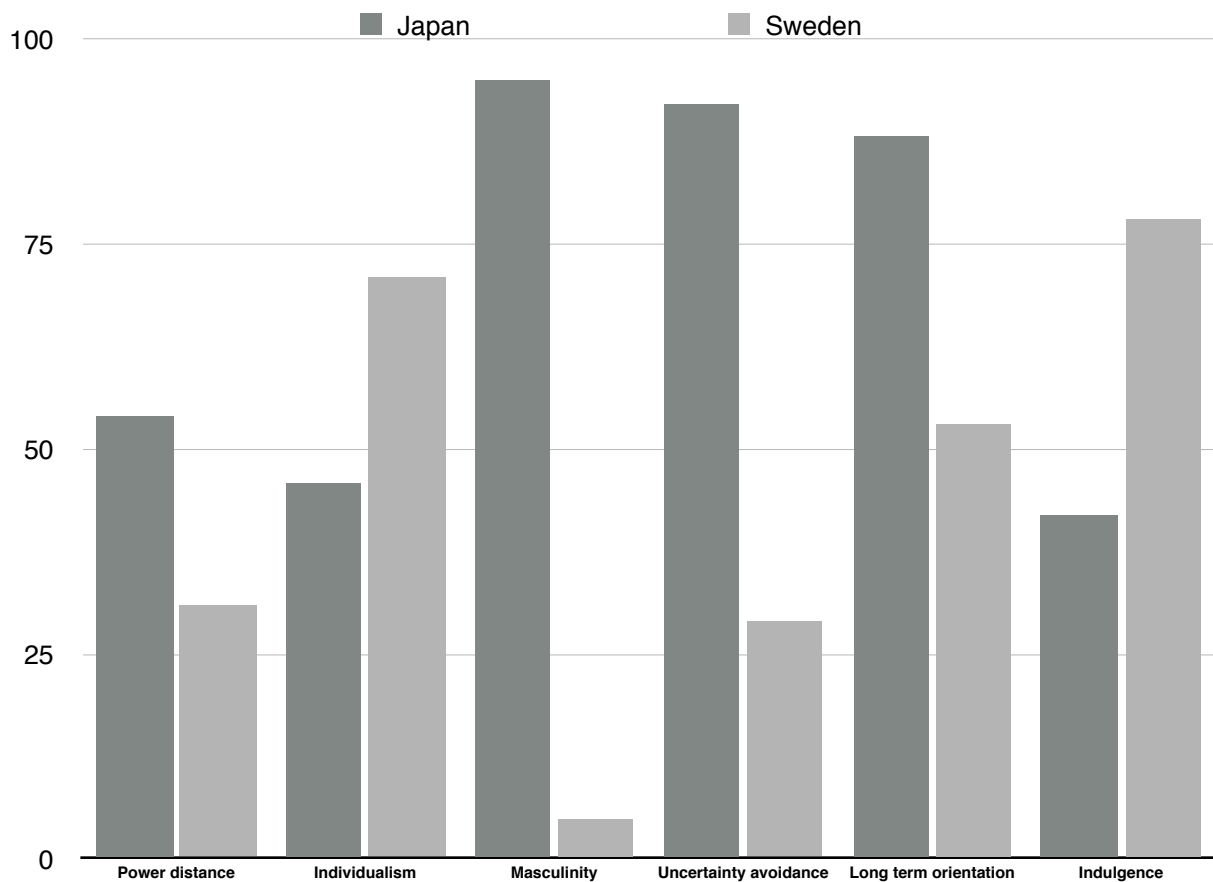
oriented. In the business context Masculinity versus Femininity is sometimes also related as “tough versus gender” cultures.

- IV. Uncertainty Avoidance Index (UAI): this third dimension expresses the degree to which the members of a society feel uncomfortable in uncertainty and ambiguity. The central point here is how we deal with the fact that the future cannot be known: should we try to control the future or just let it happen? Countries with high UAI maintain rigid codes of belief and conduct and are highly intolerant of unorthodox behaviour and ideas. A low UAI indicates a more relaxed attitude in which practice counts more than principles.
- V. Long term orientation versus Short term normative orientation: This dimension has to deal with the fact that each society deals with the future and with the past in different ways. Each culture has a different consideration of past experience and future goals. Societies that have a low score for this dimension, tend to be past-oriented, which often means that they maintain time honoured traditions and norms, while they view societal change with suspicion. On the other hand, societies that score high, are more future oriented, encouraging thrift and efforts in modern education, as a way to prepare for the future. We can also find this dimension defined as Monumentalism versus Flex-humility.
- VI. Indulgence versus Restraint: “Indulgence stands for a society that allows relatively free gratification of basic and natural human drives related to enjoying life and having fun. Restraint stands for a society that suppresses gratification of needs and regulates it by means of strict social norms”<sup>25</sup>.

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<sup>25</sup> from geert-hofstede.com

Below we can see the scores for each of these dimensions for Sweden and Japan:



*Image: comparison between Sweden and Japan for Hofstede's 6 dimensions of culture, source: geert-hofstede.com*

It is quite immediate to see how the two countries are extremely different. The following is an interpretation of the of the scores according to Hofstede's studies<sup>26</sup>.

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#### I. Power Distance:

Sweden scores low on this dimension (31/100) which means that Sweden is characterised as follows: Being independent, hierarchy for convenience only, equal rights, superiors accessible, coaching leader, management facilitates and empowers. Power is decentralised and managers count on the experience of their team members. Employees expect to be consulted. Control is disliked and attitude towards managers are informal and on first name basis. Communication is direct and participative.

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<sup>26</sup> The following paragraph is from geert-hofstede.com



On the other hand, at an intermediate score of 54, Japan is a borderline hierarchical society. Japanese are always conscious of their hierarchical position in any social setting and act accordingly. However, it is not as hierarchical as most of the other Asian cultures. Some foreigners experience Japan as extremely hierarchical because of their business experience of a slow and careful decision making process: all the decisions must be confirmed by each hierarchical layer and finally by the top management in Tokyo. Paradoxically, the exact example of their slow decision making process shows that in Japanese society there is no one top guy who can take decision like in more hierarchical societies. Another example of not so high Power Distance is that Japan has always been a meritocratic society. There is a strong notion in the Japanese education system that everybody is born equal and anyone can get ahead and become anything if he (yes, it is still HE) works hard enough.

## II. Individualism versus Collectivism:

Sweden, with a score of 71/100 is an Individualist society. This means there is a high preference for a loosely-knit social framework in which individuals are expected to take care of themselves and their immediate relatives only. In Individualist societies offence causes guilt and a loss of self-esteem, the employer-employee relationship is a contract based on mutual advantage, hiring and promotion decisions are supposed to be based on merit only, management is the “management of individuals”.

Japan scores 46/100 on the Individualism dimension. Certainly Japanese society shows many of the characteristics of a collectivistic society: such as putting harmony of group above the expression of individual opinions and people have a strong sense of shame for losing face. However, it is not as collectivistic as most of its Asian neighbours. The might be explained considering that Japanese society does not have extended family system, which forms a base of more collectivistic societies (such as China and Korea). Japan has been a paternalistic society, and the family name and asset was inherited from father to the eldest son. One seemingly paradoxal example is that Japanese are famous for their loyalty to their companies, while Chinese seem to job hop more easily. However, company loyalty is something, which people have chosen for themselves, which is an Individualist thing to do. We could say that the Japanese in-group is situational. While in more collectivistic culture, people are loyal to their inner group by birth, such as their extended family and their local community. Japanese are experienced as collectivistic by Western standards and experienced as Individualist by Asian standards. They are more private and reserved than most other Asians.

### III. Masculinity versus Femininity:

Sweden scores 5 on this dimension and is therefore a Feminine society. In Feminine countries it is important to keep the life/work balance. An effective manager is supportive to his/her team or colleagues, and decision making is achieved through involvement. Managers fight for consensus and people value equality, solidarity and quality in their working lives. Conflicts are resolved by compromise and negotiation and Swedes are known for their long discussions until consensus has been reached. The whole culture is based around “*lagom*”, which means something like not too much, not too little, everything in moderation. *Lagom* ensures that everybody has enough and nobody goes without. *Lagom* is enforced in society by “*Jante Law*” which should keep people “in place” at all times. It is a fictional law and a Scandinavian concept which counsels people not to boast or try to lift themselves above others.

Quite the opposite with Japan that scores 95/100, being of the most Masculine societies in the world. However, in combination with their mild collectivism, you do not see assertive and competitive individual behaviours, which we often associate with Masculine culture. What you see instead, is a severe competition between groups. From very young age at kindergartens, children learn to compete on sports day for their groups.

In corporate Japan, you see that employees are most motivated when they are fighting in a winning team against their competitors. What you also see as an expression of Masculinity in Japan is the drive for excellence and perfection in their material production, and in material services (hotels and restaurants) and presentation (gift wrapping and food presentation) in every aspect of life. Notorious Japanese workaholism is another expression of their Masculinity. It is still hard for women to climb up the corporate ladders in Japan with their Masculine norm of hard and long working hours.

### IV. Uncertainty Avoidance:

Sweden scores 29 on this dimension and thus has a very low preference for avoiding uncertainty. Low UAI societies maintain a more relaxed attitude in which practice counts more than principles and deviance from the norm is more easily tolerated. In societies exhibiting low UAI, people believe there should be no more rules than are necessary and if they are ambiguous or do not work they should be abandoned or changed. Schedules are flexible, hard work is undertaken when necessary but not for its own sake, precision and punctuality do not come naturally, innovation is not seen as threatening.

At 92, Japan is one of the most uncertainty avoiding countries on earth. This is often attributed to the fact that Japan is constantly threatened by natural disasters from earthquakes, tsunamis, typhoons to volcano eruptions. Under these circumstances Japanese learned to prepare themselves for any uncertain situation. This goes not only for the emergency plan and precautions for sudden natural disasters but also for every other aspects of society. You could say that in Japan anything you do is prescribed for maximum predictability. From cradle to grave, life is highly ritualized and you have a lot of ceremonies. School teachers and public servants are reluctant to do things without precedence. In corporate Japan, a lot of time and effort is put into feasibility studies and all the risk factors must be worked out before any project can start. Managers ask for all the detailed facts and figures before taking any decision. This high need for Uncertainty Avoidance is one of the reasons why changes are so difficult to realize in Japan.

#### V. Long term orientation:

With an intermediate score of 53 Sweden is seen to not express a clear preference on this dimension.

At 88, Japan scores as one of the most Long Term Orientation oriented societies. Japanese see their life as a very short moment in a long history of mankind. From this perspective, some kind of fatalism is not strange to the Japanese. You do your best in your life time and that is all what you can do. People live their lives guided by virtues and practical good examples. In corporate Japan, you see long term orientation in the constantly high rate of investment in R&D even in economically difficult times, higher own capital rate, priority to steady growth of market share rather than to a quarterly profit, and so on. They all serve the durability of the companies. The idea behind it is that the companies are not here to make money every quarter for the share holders, but to serve the stake holders and society at large for many generations to come.

#### VI. Indulgents:

A high score of 78 in this dimension indicates that Swedish culture is one of Indulgence. People in societies classified by a high score in Indulgence generally exhibit a willingness to realise their impulses and desires with regard to enjoying life and having fun. They possess a positive attitude and have a tendency towards optimism. In addition, they place a higher degree of importance on leisure time, act as they please and spend money as they wish.

Japan, with a low score of 42, is shown to have a culture of Restraint. Societies with a low score in this dimension have a tendency to cynicism and pessimism. Also, in contrast to Indulgent societies, Restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are Restrained by social norms and feel that indulging themselves is somewhat wrong.

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We can agree that the two countries are very different. It is legitimate to expect that such big differences in national culture have an impact over the management culture, human resources management, organisational culture and governance style.

If we look at the two companies we are analysing, Uniqlo and H&M, we can agree that the culture of the two countries, Japan and Sweden, have a strong influence over the whole structure, the *modus operandi*, and even over the final product.

In 1997, Fons Trompenaars and Charles Hampden-Turner published their book “Riding the waves of culture”, containing what nowadays is known as the Trompenaars’ Model of National Culture differences.

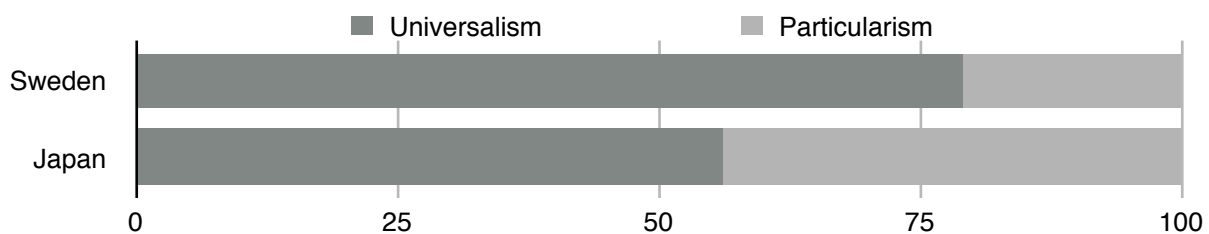
They had been analysing national cultures for more than 10 years, sending questionnaires to more than 46 000 managers in 40 countries. They discovered that the answers in those questionnaires weren’t just randomly different. They were following some specific patterns, making this differences very characteristic and predictable for each country. This because each culture has its own way of thinking, its own values and beliefs, and different preferences placed on a variety of different factors.

Trompenaars and Hampden-Turner concluded that what distinguishes people from one culture compared with individuals from a different culture, is where these preference fall in the following 7 dimensions:

1. Universalism versus Particularism: Universalist cultures are characterised by the belief that ideas and practises can be applied everywhere without modification, while Particularism, on the other hand, sees the circumstances more important than the rules, therefore each situation has to be treated differently, regardless of the formal rules and practises. This dimension relates to the question *What is more important: rules or relationships?* Universalist countries tend to refer to rules and

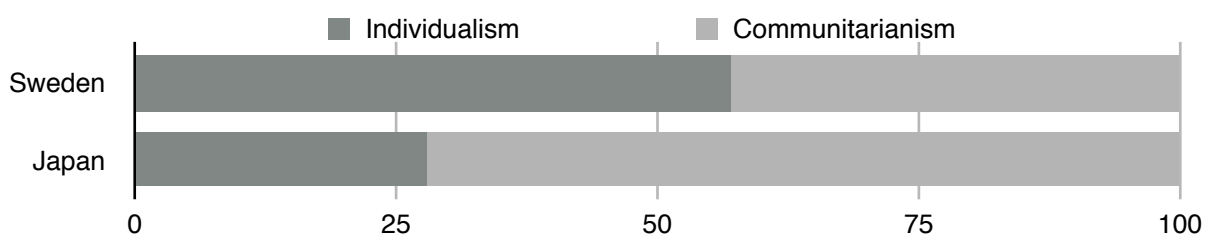
practises, business meetings follow rational, professional arguments with a "get down to business" attitude. Trompenaars found countries like USA, Canada, UK, Australia, Sweden and Germany to be Universalist. Particularist cultures see reality as more "subjective", and place a greater emphasis on relationships. It is important to get to know the people one is doing business with. It is important to build up a relationship even in business. Someone from a universalist culture knows that personal meanderings or irrelevancies are mere small talk during such business meetings. Countries that have high particularism include Venezuela, Indonesia, China, South Korea, and the former Soviet Union.

Sweden scored 79 in Universalism and 21 in Particularism. Japan scored 56, 44.



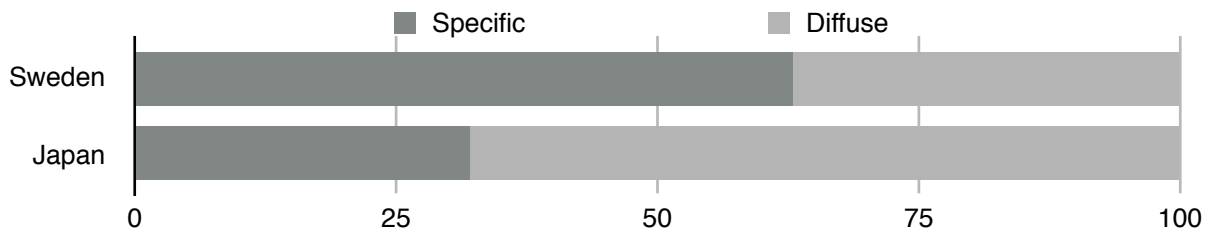
II. Individualism versus Communitarianism: This dimension refers to people regarding themselves as individuals (Individualism) or as part of their community (Communitarianism). Trompenaars's studies suggested that cultures can change more quickly than its people realise. In fact, it might be not surprising that countries as USA score high in Individualism, but countries like Mexico, and the former Soviet Union were found to score high too. This contrasts with Hofstede's earlier research, which found these countries to be collectivist, and shows the dynamic and complex nature of culture. However this might be also explained by the fact that Hofstede did its research almost 20 years before Trompenaars, so cultures might have changed in the meanwhile. Countries with high communitarianism include Germany, China, France, Japan, and Singapore.

Sweden scored 57 in Individualism and 43 in Communitarianism. Japan scored 28, 72.



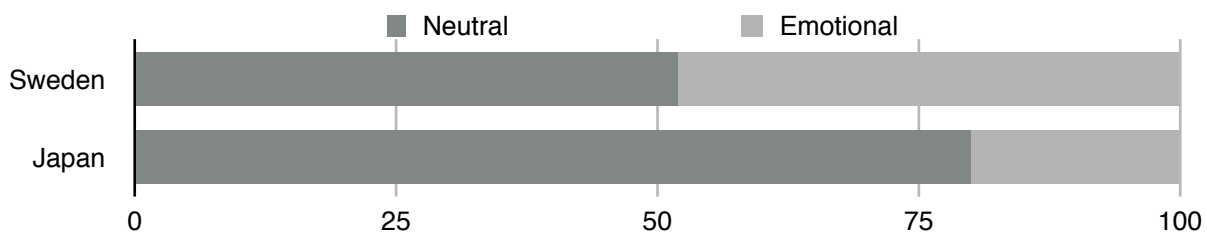
III. Specific versus Diffuse: in specific cultures, people have a wide public space that they share with others, and a smaller private space they carefully guard, and where only close people can enter. Therefore, private life and work are very separate, and relationship with people or colleagues don't have an impact on the work: it is possible to work well with colleagues while how we would like to spend time together beside the working hours. A diffuse culture is one in which the private and the public spaces have similar size, but they carefully guard their public space since entering this one, means entering the private space too. In fact, private life and public life (like at work) are overlapping. It is not rare in these type of cultures to spend spare time with colleagues or clients. Good relationships are therefore vital.

Sweden scored 63 in specific and 37 in diffuse. Japan 32, 68.



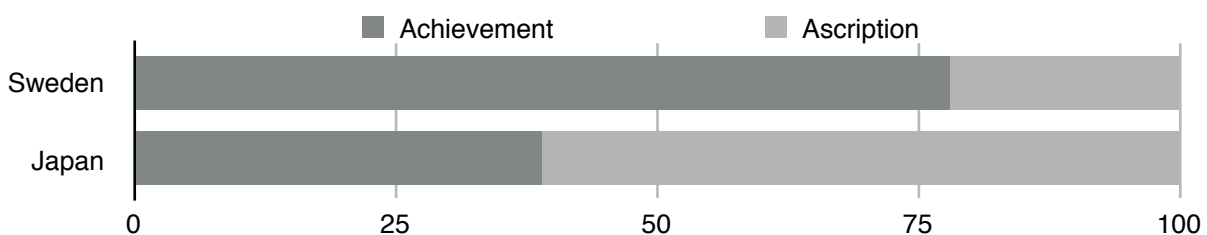
IV. Neutral versus Emotional: In neutral cultures people tend not to show their emotions, appearing “neutral”, while in emotional countries, emotions and feelings are expressed naturally. Examples of high emotional cultures are the Netherlands, Mexico, and Spain. In emotional cultures, people often smile, talk loudly when excited, and greet each other with enthusiasm. So, when people from neutral culture are doing business in an emotional culture they should be ready for a potentially animated and boisterous meeting and should try to respond warmly. As for those from an emotional culture doing business in a neutral culture, they should not be put off by a lack of emotion.

Sweden scored 52 Neutral, 48 Emotional. Japan 80, 20.



V. Achievement versus Ascription: In an Achievement culture people's status depends on their performances and on how good they are performing their functions. Therefore these cultures value performance. In Ascription cultures, status is based on who that person is, so power, position and titles are important. This dimension refers to the question Does a person have to prove himself to receive a status or it is given to them?

Sweden scored 78 Achievement 22 Ascription, while Japan scored 39 Achievement, 61 Ascription.

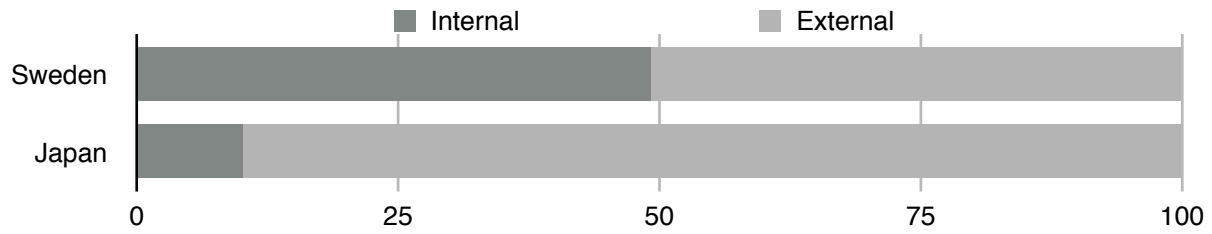


VI. Sequential time versus Synchronous time: In Sequential time cultures people like events to happen in order. They put a high value on punctuality, planning and scheduling. These are the cultures of “time is money”, therefore these people don't like when their schedule is put away. In Synchronous time culture, there is no clear border between past, present and future. This 3 dimensions of time are interwoven. People often carry on many projects at once and see plans and commitments as flexible.

Sweden 33% past, 35% present, 32% future oriented, therefore Sweden is slightly more Present oriented. Japan 23% past, 38% present, 38% future oriented, so we can say that Japan is more Present and Future oriented.

VII. Internal direction versus External direction: This last dimension is related to people's attitude towards nature: *Do we control nature or are we controlled by nature?* In Internal direction cultures people tend to control the nature or environment in order to achieve their goals, in terms of how they behave inside an organisation or at work. In external direction cultures, people believe that it is their environment to control them. At work or in relationships, they focus their actions on others, and they avoid conflict where possible. People often need reassurance that they're doing a good job.

Sweden scored 49 in internal direction, 51 external direction. Japan 10 internal , 90 external.





## Chapter 5

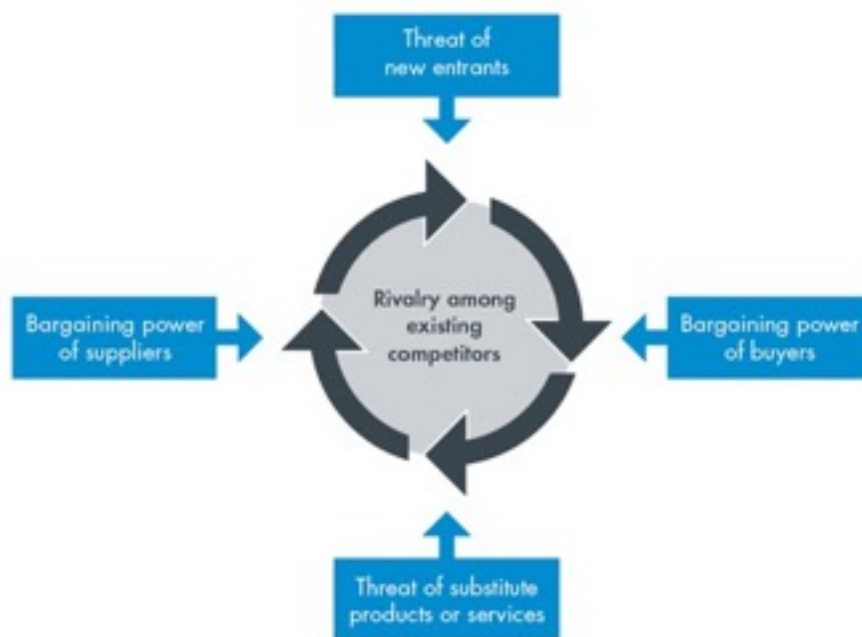
### Strategic Analysis

So far we have reported the two companies' history, business models, sales information, CSR information and cultural background information.

We will go on analysing the sector and the strategy of the two companies, Uniqlo and H&M.

The global apparel market was valued at 1.7 trillion USD in 2011, employing 75 million people all over the world<sup>27</sup>.

But is the apparel sector structured? We will proceed in analysing it with the Porter's five forces model:



*Image: Porter's five forces model, Source: cgma.org*

- I. Rivalry among existing competitors: as we said, the apparel industry is a very competitive one. The market is mature and quite saturated. For both Uniqlo and H&M, USA and China are new strategic markets on which they are focusing. For what concerns China, first they entered the market placing flagship stores in first tier cities, and gradually they opened in second and now third tier cities. They are facing the fierce competition of other apparel global players, as Inditex (with Zara,

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<sup>27</sup> From [fashionunited.com](http://fashionunited.com)

Pull and Bear, Massimo Dutti, Stradivarius, Bershka and recently Zara Home), GAP, American Apparel etc.

- II. Threat of new entrants: small local stores can be opened easily. But being H&M and Uniqlo among the first four global players, it is hard for new entrants to get to a level to compete with them. Both of them are able to keep a good quality of the product, together with a reasonable price, because of the large amount of material that they buy, and because they produce in low cost labour countries as China or Bangladesh. However, H&M, for instance, might be a threat to Uniqlo when entering a market where there is already Uniqlo. For example, for the year 2015, H&M planned to enter the following markets: Taiwan, Peru, Macau, South Africa and India. Among these, Uniqlo is already present in Taiwan with 46 stores. Therefore, H&M might be a treat for Uniqlo in Taiwan. So we can say that the treat of new entrants is more connected to the tread of one of the main players trying to enter a market where one, or more, of the other main players, is already present.
- III. Bargaining power of buyers: as we said, the competition in the fast-fashion-apparel is high, therefore customers have a wide choice. The switching cost for a buyer is very low, so what the four main players, H&M, Uniqlo, Zara, and GAP, can do, is to differentiate themselves. In fact, the four brands are actually different. H&M is a cheap but trendy clothing, and mainly is a competitor for Zara, which is a bit more expensive and fancy, Uniqlo is more technical, material-innovation focused, and GAP is more sporty. Therefore a customer looking for a fancy evening dress, for example, would probably not go to visit Uniqlo and Gap, and on the other hand, somebody looking for good quality winter coat, wouldn't probably visit H&M, but Uniqlo. We can say that the four main players are handling the competition between each other quite well, and since they are the main four fast fashion retailers in the world, they don't fear the completion coming from smaller competitors.

The customer loyalty in Europe is quite high. In 2010 computing.co.uk published an article titled "H&M and Zara rushed web sites to detriment of customer loyalty, says analyst", saying that the badly-done websites of these two main competitors were discouraging customers from buying in their shop on line, because "*...the brands have not successfully localised their sites, meaning that they fail to offer correct currency and payment methods on occasion, and do not take some local cultures into account. Many of the text boxes on the Finnish and Danish H&M sites show English text, for example.*", the article states. However, five years later, the websites are in each language, currency, size system, payment method and so on, according to each country. However customer loyalty might be lower in those

countries where Uniqlo and H&M are new entrants, and where customers have way more fast-fashion offer variety.

- IV. Threat of substitute products: in some markets, substitute product for fast fashion might be sport wear. For instance, in China global sportswear brands are very popular and considered to be fashionable. Luxury brands are also very popular in Asian countries. Therefore these two types of products might be a substitute to the fast fashion. Compared to sportswear, the products developed by H&M are more fashionable and trendy, while Uniqlo might offer similar technical materials (as AIRism and HEATTECK) at lower prices and trendier designs. On the other hand, luxury is a high end product, for a limited target.
- V. Bargaining power of suppliers: Both H&M and Uniqlo buy massive quantities of raw materials as cotton and wool, especially H&M, which is globally the largest consumer of organic cotton. Given the massive quantity of raw materials that both the companies buy every year, and the long term relations with suppliers, we can say that the bargaining power of suppliers is low.

For example, if we give a look to the costs that H&M faced in 2014, we see that the cost of the sold products is 57 322 mil SEK, excluding administrative costs, selling expenses and the depreciation<sup>28</sup> of equipments, brands, customer relations and assets, while the sales, excluding VAT, are 151 419 mil SEK. If we consider the suppliers of fabric and yarn, H&M buys from the following number of suppliers: 6 in Pakistan, 14 in Bangladesh, 7 in India, 3 in Thailand, 1 in Taiwan, 7 in Indonesia, 89 in China, 34 in Turkey<sup>29</sup>. The production of H&M is based on partner factories or owned factories, among which the first ones are the majority, and therefore are suppliers. These supplier factories are divided in Manufacturing Factories and Processing Factories, where the Auditors of H&M keep a tight control over the whole supply-chain. These factories are located in Bulgaria, Czech Republic, Greece, Italy, Spain, Romania, Latvia, Netherlands, Portugal, Sweden, Egypt, Ethiopia, Kenya, Tunisia, Turkey, Cambodia, China, Indonesia, Myanmar, South Korea, Taiwan, Thailand, Vietnam and Bangladesh, for a total of 1926 factories for 900 suppliers, among which the biggest ones are located in China, Tur-

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<sup>28</sup> From the H&M Annual Report 2014: "Depreciation has been calculated at 12 percent of the acquisition cost of equipment and leasehold rights, and 20 percent for computer equipment and vehicles. Depreciation on brands and customer relations relating to FaBric Scandinavien AB and capitalised development expenditure is assessed at 10 percent of the acquisition cost. Buildings are depreciated at 3 percent of their acquisition cost. No depreciation is applied to land values."

<sup>29</sup> From sustainability.hm.com "our supplier factory list"

key, Bangladesh, India and Cambodia<sup>30</sup>. It is evident that the bargaining power of H&M is high.

On the other hand Fast Retailing has only roughly 70 partner manufacturers for Uniqlo, they say that is little number, compared to other fast fashion companies, it is because they want to make sure that the products meet their quality standards. As an advantage, Uniqlo has the very long term partnerships with these manufacturers, to whom it assures purchase of large quantities and therefore cuts down the purchase cost.

Competitive advantage:

H&M<sup>31</sup> has an attractive top-line growth story that is highly attractive for investors. Its flexible planning of product range and quick decision making, gives the company an advantage in meeting customers expectations and a better sell-through. We believe that the main competitive advantage is given by the fact that H&M delivers fashion at affordable price. The time from design to in-store placement can go from a few weeks to 6 months. In particular, H&M, as we already said, classifies its products in basics, fashion-basics and fashion products, maximising the low cost production and production time on basics, since here the demand is easier to predict, while it is worth to invest more resources in a quick response in high fashion products, with smaller volumes and tighter timing, where it makes sense to sacrifice cost efficiencies in production for speed-to-market and full price sale. This way H&M can have higher margins, even compared to its competitors, on medium to high fashion.

There are 160 designers and 100 pattern makers at H&M, while the manufacturing is on independent suppliers, mainly in Asia and Europe. The distribution is made by H&M and the garments are then sold in H&M stores. Given the large amount of commission given external manufacturers, and the high bargain power of the company, H&M can benefit of scale. The majority of shipments goes straight to local logistic centres that support stores. The stores themselves do not have backup stocks but are replenished as required from these logistic centres. The inventory levels are, this way, driven by a pull-strategy instead of a push-strategy, cutting

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<sup>30</sup> From sustainability.hm.com "Choose and reward responsible partners - our Conscious Actions"

<sup>31</sup> This part is based on "H&M has a narrow economic moat, but investments and increased costs will likely pressure margins" by B. Weishaar, March 26th 2015, on analysis report.morningstar.com, Morningstar.

down some of the gross margin risk connected to promotional activity and excess merchandise.

We can say that H&M has a cost advantage over its competitors, thanks to scale and fast fashion manufacturing strategy, but still its product is trendy and fashionable. Moreover H&M can count on a strong brand identity making its stores an almost certain destination for customers looking for fashion apparel.

Collaborations with well known designers are Lanvin, Karl Lagerfeld, Jimmy Choo and so on, gave H&M more credit in terms of fashion-apparel, rather than low-cost apparel, attracting in its stores also customers from higher targets. Inter-breed ranked H&M at the 21st position in its Best Global Brand Ranking 2014, immediately before Nike, being H&M the first apparel brand in this Ranking, followed by Zara at the 36th position, Gap at 99th.

Uniqlo, under the parent company Fast Retailing, is the most successful Japanese fashion retailer, and the fourth global retailer in fashion apparel. Unlike H&M Uniqlo has a strong vertical integration, controlling the whole process from design to sale through Uniqlo stores, and a way longer lead time, especially for basics that are, as we said its goldmine. On its side, Uniqlo has some advantages like a low cost production, given by the long term partnership with its suppliers, and by the large amounts of purchase from these, the wide range of basic garments, that have a reasonable price and offer high tech materials and high quality. Uniqlo targets different age tiers, and different targets of consumers. It is suitable for young, high school and University students, and professionals seeking for high comfort items. On the other hand, Uniqlo doesn't have such a strong brand recall as H&M, especially out of Asia, given its limited presence in European markets. This last "weakness" of Uniqlo, however, might be an opportunity of growth in the next years. Compared to H&M, Uniqlo probably offers a better shopping experience, and therefore sale assistance: often, H&M's stores are not very clean and sometimes are quite messy, especially during the sales period. Uniqlo's stores are perfectly in order and the merchandise is organised by colour in a rainbow display, for example, or to the item. In conclusion, we might say that Uniqlo offers a very high quality, compared to H&M, without compromising the attractiveness of the price. In general, compared to the other three main apparel players, Uniqlo offers something different, the highly engineered materials and an overall good quality of clothing, resulting in a high overall value for the set price.

Uniqlo offers a very different product from H&M. In fact Uniqlo is high tech material and quality focused. One of the Uniqlo's most famous items is the

Heattech, launched in 2003, it was created with the strategic partner Toray Industries, which is also the world leader fiber maker. Heattech is an innovative material which keep the body heat and absorbs the moisture, but at the same time it is very light and thin, 0.55mm. Since 2013, a new upgraded version is available in store, the Heattech Ultra Warm, now with camellia oil extracted additive, to make it even smoother and more comfortable. The price of a ultra warm Heattech for woman, long sleeves and round neck, is 24.90\$<sup>32</sup>. In fact Uniqlo's prices are slightly higher than H&M's, but as we said Uniqlo offers a higher quality, durability, and material innovation. We might therefore state that Uniqlo is pursuing a differentiation strategy, offering new high tech materials that its main competitors in the fast fashion retail market do not have.

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<sup>32</sup> From the American Uniqlo online store, in June 19th 2015.

## Chapter 6

### Conclusions:

The global apparel market was valued at 1.7 trillion USD in 2011, employing 75 million people all over the world.

The low price fashion market, is crowded but highly concentrated in the hands of four main players: the Spanish Inditex, the Swedish H&M, the American Gap and the Japanese Fast Retailing. These four register very high profits, and gross margins of, respectively: 56.5%, 59%, 37.8% and 50.6%, very high if compared to 2 of the most valuable brands, Apple 40.8% and HP 24%.

Inditex, H&M, Gap and Fast Retailing, are generally similar, even if we saw that they are following different strategies. We can, however, outline some common features, that are:

- a customer age that goes roughly from 0 to 40 years old,
- a trendy product for an affordable price
- a quick response to the new trends
- a frequent assortment change

Each of the four follows this pattern with different intensity and priority. For all the companies in apparel market, timing is fundamental. Some of them might emphasise it, as Zara (Inditex) and H&M, that push the the production moment so close to the sales moment, that they have managed to reduce the lead time up to 2 weeks, while some companies might give a little less importance to it, as Uniqlo (Fast Retailing) that, as its CEO and Chairman Tadashi Yanai states, “does not chase after fast fashion trends”, but focuses on quality and material innovation. Here lays the main difference between Uniqlo the the more properly-fast-fashion Inditex and H&M: the Uniqlo typical customer does not renew his or her wardrobe according to the latest fashion trend, but according to the latest material innovations. Uniqlo’s garments stay in store way longer than Zara or H&M products, which are “refreshed” every 2 weeks on average.

This Fast Fashion gold rush, put in the spotlight some problems as pollution and low cost labour exploitation. The average water consumption for the production of 1 T-shirt, (from growing the cotton to its final production) is 2700 litres. 1 Kg of cotton implies on average, a 3.3 Kg emission of CO<sub>2</sub>, and H&M is the biggest organic cotton consumer in the world. Most of fashion retailers, in order to cut down production

costs, manufacture in low cost labour countries, as the south east asian countries. In particular China, Thailand, Indonesia, Vietnam and Bangladesh, where the last one is the most textile-specific country. Both Uniqlo and H&M produce, not only, in Bangladesh. In April 2013, the Rana Plaza, a commercial building, collapsed, and put the labour issues on the spotlight. The Rana Plaza was a 8-floor building, located in the southern suburbs of Dakka, Bangladesh. Although it was supposed to be just a 4-floor commercial building, with stores, offices and apartments inside, the last 4 floors were added without permission, and big textiles factories were located in, together with a handful of stores and a bank. The factories were employing 5000 people. In the early morning of April the 24th 2013, the building collapsed due to structural failure, more than 1100 workers died and another 2500 were rescued from the building. Among the 4 main players in this study, only Inditex was purchasing garments from that factory. This tragic event brought the theme of corporate social responsibility back, and fashion retailers are now more careful about working conditions. Both Uniqlo and H&M have tightened their control over their suppliers.

As we said, but of the companies, Uniqlo and H&M, are clearly focusing on China. For instance, in its Report, Uniqlo states that they aim to open 100 stores for year in China. We have discussed about consumer market in China and about how it changed, from a easy-to-sell-in market, where brands were enough to make the product appealing, to a more demanding market, where quality the the overall shopping experience is taken into consideration too. Since big metropolitan cities are already crowded with all kinds of fashion retailers, second and third tiers cities (medium and smaller), are becoming quite important for growth maintenance. China is changing also from manufacturing point of view: if, on one hand China is becoming more opened to foreign investment in many sectors that previously were closed or almost restricted to foreign investors, on the other hand the manufacturing in China is becoming more expensive than it used to be, and this for several reasons:

- the working-age population is decreasing. If 20 years ago the Chinese government was keeping a GDP growth at a minimum of 8% annual in order to maintain a full employment of the working population, which was increasing of 10 million people per year, in 2010 the situation was already the opposite, with the working age population decreasing of 3.5 million.
- wages are increasing, this is also because of people accessing higher education and working age population decrease.
- rising energy cost: “[...] Much of the problem lies in China’s industrial structure. “There is not much transparency in how authorities set domestic oil prices and a



good system of supervision is not in place,” says Dong Zhengwei, a lawyer and veteran campaigner against state-owned monopolies. “The government wants to protect the interests of large oil companies.” Increases in the state-set natural gas price were designed to offset import losses for state oil companies and encourage them to produce more gas, but the price rises have deterred industrial customers. “It’s one of the few markets in the world where industrial gas prices are higher than residential prices,” says Kim Woodard, an investment adviser in Beijing. [...]

Most of China’s industrial sector still relies directly on coal, the cheapest fuel around, but by 2010, 28 per cent of Chinese industry’s energy needs were met by electricity, surpassing the level of industrial electrification in the US. The switch has helped mitigate noxious coal pollution in wealthier cities but made managing energy costs more complicated for Chinese companies.

This is important, because power can account for up to 90 per cent of a factory’s cost, depending on the industry. [...] “<sup>33</sup> and so on.

All these cost increase, are making the other south east asian nations appealing for cheap production, as Bangladesh, which is also the most textile specific country, where the 77% of the overall country export is made of textiles.

We took as example 2 companies among the four biggest players in fashion retail market: the Japanese Uniqlo and the Swedish H&M. The first one seems to pursue a differentiation strategy, focusing more on material innovation and high quality, thanks to its strategic partner Toray Industries, the global market leader for synthetic fibres. In fact Uniqlo’s products have a longer shelf life compared to the other 3 global competitors. prices are slightly higher, but there is a big difference in quality and product duration. A clear example of it is Heattech, one of the core products of Uniqlo and also its goldmine. H&M, on the other hand seems to pursue a cost reduction strategy, cutting down the production cost, thanks to its high bargaining power and its 600 suppliers, the logistic costs, and the lead time, which allows H&M to see its products full price.

We quickly went through that typical Corporate Governance models of the 2 countries, Japan and Sweden, outlining how the Japanese model still lacks in transparency and minor shareholders protection. Fast Retailing’s shares are mainly in the hands of the president Yanai, in whose person the role of President, Chairman and CEO are over-

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<sup>33</sup> From Financial Times, Doing Business in China “Rising energy, transport and labour cost squeeze profit of Chinese companies”, author: Lucy Hornby on [www.ft.com](http://www.ft.com)

lapping, and banks', as the Japanese model wants. Swedish shares are very concentrated in the hands of the founder and family too, but still the Swedish model provides a stronger transparency and minor shareholders' protection.

We analysed the main traits of the 2 respective cultures, according to the theories of Hofstede and Trompenaars. The 2 countries are obviously different from cultural point of view, and this has an impact on the governance model, the transparency and the general way of being. For example, Fast Retailing put a strong emphasis on being a Japanese company. In their Report, many time they mention "Japanese company", "Japanese essence" and so on. For instance, considering the Hofstede' dimension for Individualism vs Collectivism, Japan scores more collectivistic than Sweden. This might influence the fact that the Uniqlo products are basic, casual design, blend-in design, while H&M, from the Individualistic Sweden, tends to have more striking, last trend designed. If we gave a look to the Masculinity vs Femininity dimension, Japan is one of the most masculines countries in the world. This implies that Japan is success and excellence oriented. This is evident in the Uniqlo attitude toward being the number 1 brand in Japan, or looking at the President Yanai, who is the richest man in Japan. looking at Trompenaars dimensions, the Specific vs Diffuse dimensions tells us on how the public vs private life are separate or overlapping. Japan is very diffuse compared to Sweden, this means that in Japan private and public sphere are overlapping, and therefore entering somebody's public life means entering his private life too.



*Image: Fast Retailing Board of Directors, the Chairman Tadashi Yanai is sitting on the right. Source: FR Annual Report 2014*



*Image: H&M Board of Directors, the son of the founder and actual Chairman is sitting on the left. Source: H&M Annual Report 2014.*

Moreover, social status in Japan is quite important. If we give a look to the 2 Boards, the Japanese one is composed only by men (there is only 1 woman, among the Auditors), and all of them are third age. The Swedish Board has more women than men, the average age is lower, and also their appearance is less formal. In general, in Asian countries appearance is important and this is evident also in Uniqlo's design, way more basic and classic, and more material oriented, than H&M. In Sweden, Achievement is more important than Ascription, so there are more young people in key positions, and the general environment is less formal. Facts are more important than papers.

In conclusion, Fast Retailing and H&M are two profitable companies. At a first glance they might look very similar, since they are both operating in the apparel market, and they are competitors. But looking in deep, they pursue different strategies and they come from two different backgrounds, which obviously has an impact on how they are.

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